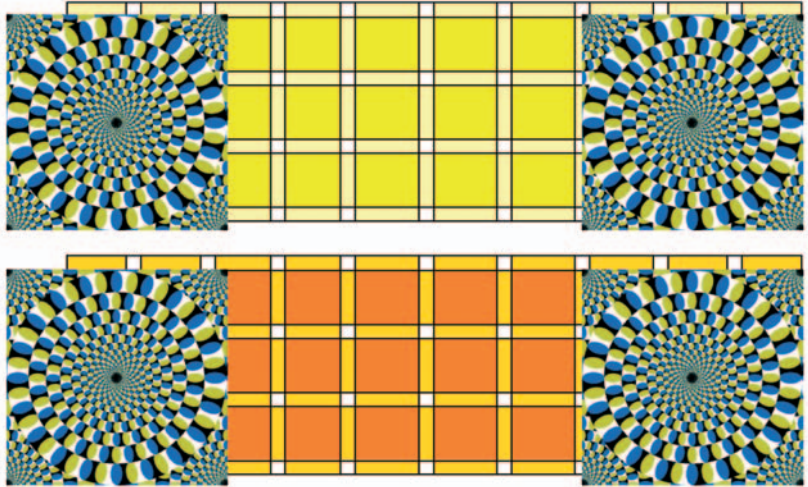
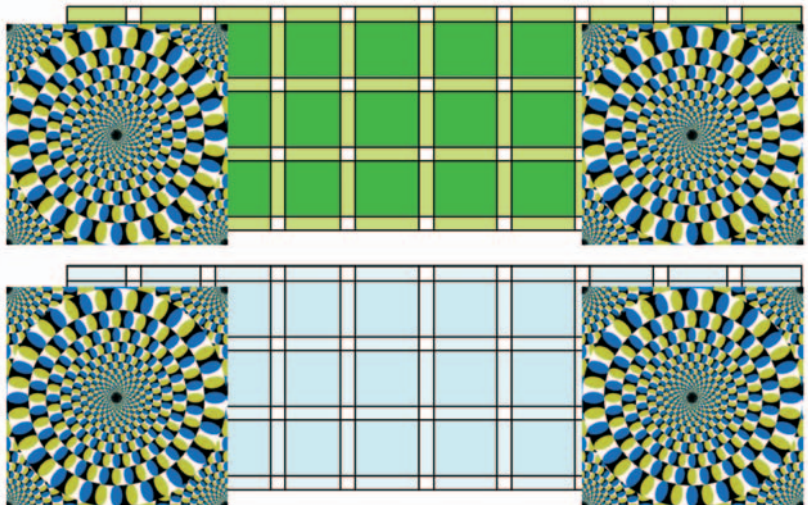


PAUL W.L. VLAAR

Making Sense of Formalization in Interorganizational Relationships



Beyond Coordination and Control



Making Sense of Formalization in Interorganizational Relationships: Beyond Coordination and Control

Making Sense of Formalization in Interorganizational
Relationships: Beyond Coordination and Control

**Betekenis geven aan formalisering in interorganisatorische
relaties: een stap verder dan coördinatie en beheersing**

Proefschrift

ter verkrijging van de graad van doctor
aan de Erasmus Universiteit Rotterdam
op gezag van de rector magnificus
Prof.dr. S.W.J. Lamberts
en volgens besluit van het College voor Promoties.

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PREFACE

Often, we do not realize that contracts, rules and procedures constitute a large part of our daily lives. When we discuss issues among colleagues, we use rules of speech; when we travel to work, we observe formal traffic rules; and, when handing in a dissertation to obtain a doctorate, we follow formal procedures. Moreover, various memorable moments in a person's life, many of which I have been so fortunate to experience during the last four years, are accompanied by formalities. The purchase of a house involves formal bidding procedures, signing of a sales contract, handing in formal writings for the land register, and proceeding through formal procedures at the conveyance. Marriage entails responsibilities and commitments of partners, which are laid down in marriage registers and marriage certificates. Finally, the birth of a baby is recorded in a register of births, and formal notifications have to be sent to insurance companies, day-care centres and social-security agencies.

It was not until I had experienced these events myself, that I realized that some of the formalities associated with these events meant more than appeared at first sight. I became aware of the fact that developing contracts, rules and procedures is frequently hardest when you need them most, eventuates in tensions with which people have to cope, and makes sense in the literal sense of the word. Moreover, I realized that acts of formalization are hard to study in isolation, frequently possess a standard format, and interact with relational and other governance mechanisms. When attempting to further develop and investigate these insights, it became obvious that a tough job lay ahead. Research on formalization in interorganizational relationships has been dominated for decades by theories that have taken up an almost paradigmatic status. The challenge lay in accommodating and cherishing these existing perspectives on the role of formalization in interorganizational relationships, while at the same time attending to and developing new ideas that could possibly result in scientific progression. I believe this manuscript gives testimony as to how such an endeavor can enrich our thinking on interorganizational governance. I wish to thank Margret and Sam, my family, friends, promotors and colleagues in Rotterdam and in many other places around the world for their tremendous support during the journey that has eventuated in this manuscript. They are the ones who made my voyage a precious intellectual and personal experience.

Paul Vlaar

Alkmaar, January 2006

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1 INTRODUCTION TO THE STUDY

‘Managers take one narrow perspective or another [...]. Much of this writing and advising has been decidedly dysfunctional, simply because managers have no choice but to cope with the entire beast.’

Mintzberg and Lampel, 1999: 21

‘Several competing lines of reasoning seem possible, although they might prove to be complementary rather than exclusive, since organizations are complex realities whose dynamics are “overdetermined” and not typically amenable to a mono-causal explanation.’

Adler, 1993: 172

1.1 Introduction

This chapter serves as the introductory guide to a study on the role of formalization in interorganizational relationships. We start with a short discussion on the salience of interorganizational cooperation in contemporary society. Subsequently, we emphasize the significance of formalization – provisionally defined as the development and application of contracts, rules and procedures, and the efforts made to enforce those – for collaborative relationships. We then contend that existing studies on formalization generally take one narrow perspective or another, neglecting the fact that managers have no choice but to cope with the entire “beast”, and ignoring the fact that most organizational phenomena are unamenable to mono-causal explanations, as is paraphrased by Mintzberg and Lampel (1999) and Adler (1993). Consequently, an integrative perspective on the role of formalization in interorganizational relationships has hitherto remained absent in the literature. We respond to this lacuna, by introducing an integrative research framework for investigating the role of formalization in interorganizational relationships. To elucidate each part of the framework, we identify six research themes on which we elaborate in the study. After clarifying each of these research themes and the research questions associated with them, we explain the aim and scope of our inquiry, and we discuss the empirical basis for the study. The chapter concludes with an overview of the structure of the thesis.

1.2 Interorganizational cooperation

Drucker (1995) suggests that the greatest change in the way business is being conducted is the accelerating growth of relationships based on partnership instead of ownership. Grant and Baden-Fuller (2004: 61) even contend that ‘one of the most important trends in industrial organization of the past quarter century has been the growth of collaboration between independent companies.’ Several other researchers have noted that organizations are increasingly forming external relationships in the form of strategic alliances, partnerships and outsourcing deals. Kang and Sakai (2001), for example, found that the number of interorganizational alliances was six times as high in 1999 compared to a decade earlier. The top 500 global businesses have been estimated to participate in an average of sixty major

strategic alliances each now (Dyer et al., 2001), while public reports indicate that BP Amoco, Dow Chemical, Hearst, Johnson & Johnson and Sony had more than a hundred alliances in their corporate portfolios by 2001 (Bamford and Ernst, 2003). Large pharmaceutical companies ALSO constitute a major example of the hunger for interorganizational cooperation (see Table 1.1). The top 10 in this industry has established, on average, 61 new alliances from 2000 to 2003 (Rasmussen, 2004). At the same time, Goldman Sachs estimates that a typical Fortune 1000 organization is already maintaining between 20,000 and 40,000 contracts (upsidesoft.com, 2005), and a survey by Schifrin (2001) indicates that more than eighty percent of the top-level managers interviewed regard strategic alliances as a primary growth vehicle for the future. Other types of interorganizational relationships are also predicted to grow in volume and number. The worldwide market for IT outsourcing, for instance, has been forecast by Gartner to grow at an annual compound growth rate of 7.2 percent between 2003 and 2008 (Caldwell et al., 2004). This suggests that the trend towards collaboration can be expected to continue.

TABLE 1.1
Number of alliances top 10 drug development companies (2000-2003)

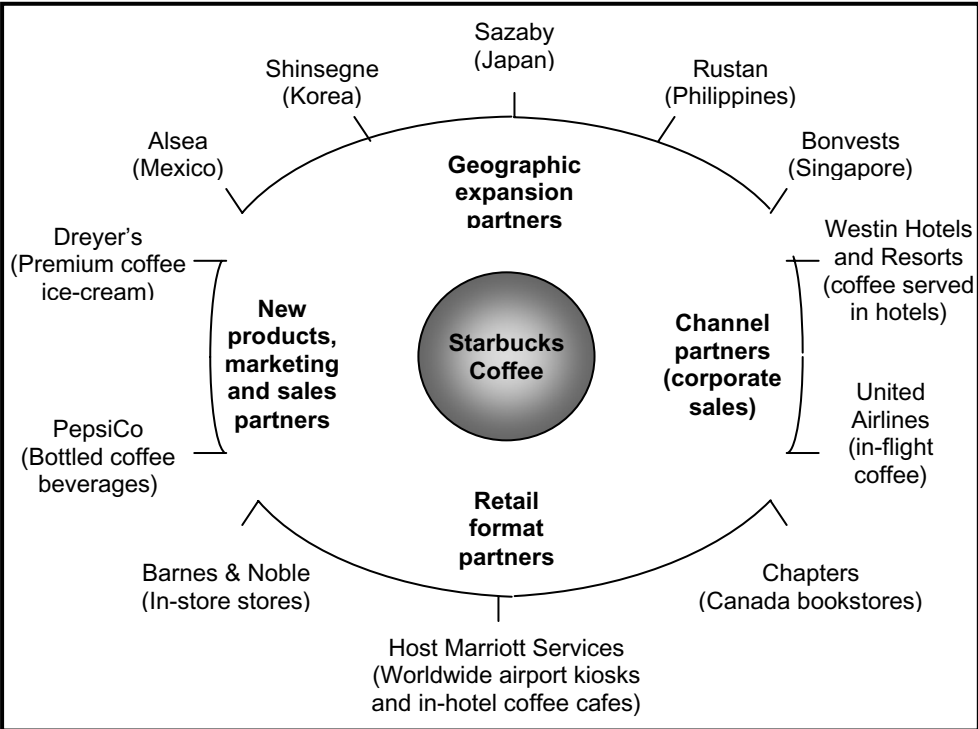
Company	# of world-wide alliances
Pfizer	103
GlaxoSmithKline	88
Merck	62
Aventis	57
Roche	56
Novartis	56
Eli Lilly	51
Bristol-Myers Squibb	47
Abbott	45
AstraZeneca	44

Source: Rasmussen (2004, based on Recap, March 2004)

These examples suggest that organizations rarely create value in isolation anymore. Their activities are embedded in complex networks of interorganizational relations and in constantly reconfiguring value chains (Wirtz, 2001). Changes in communication technologies and an increasing openness of economies have amplified the potential value that may be created through interorganizational cooperation, permitting organizations to set up closer relationships with partners than hitherto possible (Mol, 2005). Take the example of Starbucks Coffee, which

has leveraged a brand and a concept by means of a large set of interorganizational relationships (see Figure 1.1). Starbucks's partners include firms that facilitate entry into new markets; customers, including United Airlines and Westin Hotels; retail formats, such as Marriott, Barnes & Noble and Chapters; and producers of complementary products, including PepsiCo and Dreyer's Ice Cream (see Ernst, 2003). Another example constitutes Accenture (see Figure 1.2), which has developed relationships in the areas of application infrastructure, business intelligence, customer relationship management, data warehousing, enterprise integration and management, platforms and supply chain management. Nowadays, cooperation is even extended to strategically sensitive areas, such as R&D. Boeing, for example, is working with India's HCL Technologies to co-develop software for everything from the navigation systems and landing gear to the cockpit controls for its upcoming 7E7 Dreamliner jet. Similarly, pharmaceutical giants such as GlaxoSmithKline and Eli Lilly are teaming up with Asian biotech research companies in a bid to cut the average \$ 500 million cost of bringing a new drug to the market (Engardio and Einhorn, 2005: 52-53).

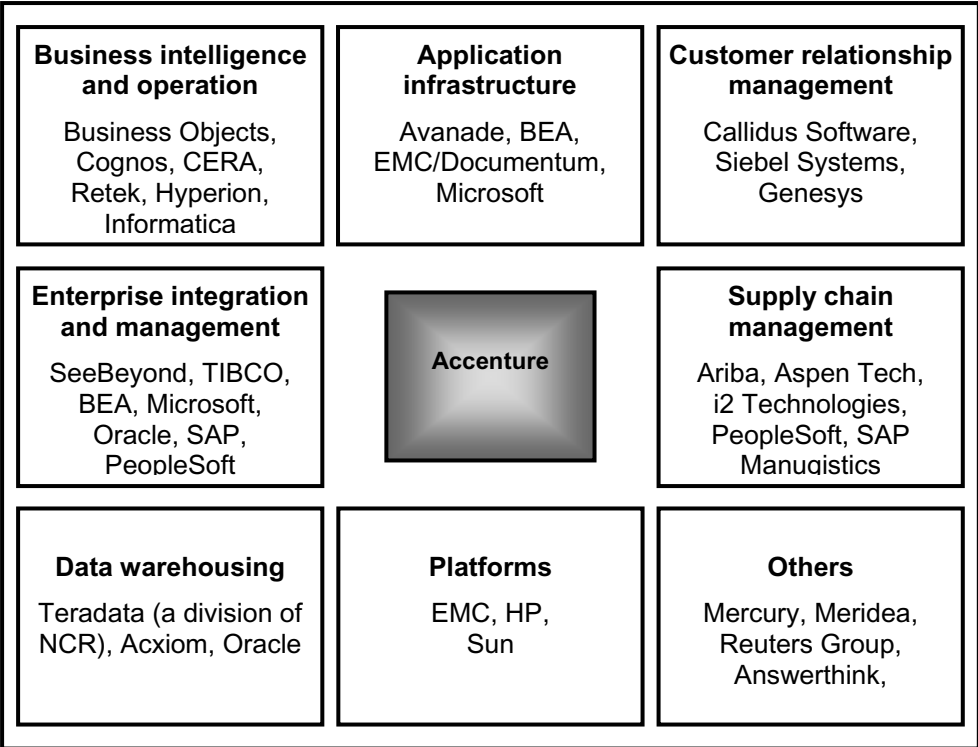
FIGURE 1.1
Starbucks's coffee: Creating value through a set of relationships



Source: Ernst (2003, based on press reports and McKinsey Analysis)

What drives these organizations to ally, frequently with their closest competitors? Lerpold (2003) and Ariño (2003) have composed excellent overviews of the motives for forming interorganizational relationships, which include: reducing production and transaction costs (Hennart, 1988; Williamson, 1985); enhancing flexibility (Volberda, 1996, 1998; Schilling and Steensma, 2001); expanding business activities and exploiting business opportunities abroad (Mohr and Puck, 2005); augmenting market power through competitive positioning (Kogut, 1988); accessing complementary resources and capabilities (Doz and Hamel, 1998; Dyer and Singh, 1998); and opening up possibilities to learn, and access, transfer, transform and harvest knowledge (Beamish and Berdrow, 2003; Grant and Baden-Fuller, 2004). In addition, interorganizational cooperation has been argued to confer status, legitimacy and reputation on organizations (Baum and Oliver, 1992; Nicholson et al., 2002). In addition, it assists in augmenting identity (Lerpold, 2003); enables conformance to isomorphic bandwagon behavior (DiMaggio and Powell, 1983); helps organizations respond to networks of competitors (Gimeno, 2004); and accelerates the pace of organizational growth (Grant and Baden-Fuller, 2004; Shane, 1996; Uzzi, 1997).

FIGURE 1.2
Accenture: Creating value through a set of relationships



Source: composed on the basis of data located at www.accenture.com

Moreover, interorganizational relationships afford benefits, in the form of a larger volume, diversity and richness of information available to organizations (Koka and Prescott, 2002). They may thereby quicken the pace of innovation and reduce the risks associated with exploration (Sivadas and Dwyer, 2000). Interorganizational cooperation is further driven by the fact that competition does not take place between individual organizations alone anymore (Ireland et al., 2002). Instead, it involves constellations of firms (Van Haverbeke and Noorderhaven, 2001), or cliques (Rowley et al., 2004). In a sense, interorganizational relationships thus create 'new forms of competition that supersede firms and on which firms depend for their competitive advantage' (Gomes-Casseres, 1996: 204). Battles among airline constellations Star and Oneworld in the early 2000s form a good example here (Bamford et al., 2003).

Beyond offering organizations new ways of creating value, external cooperative agreements enable organizations to draw 'their boundaries around narrower spheres of activity' (Whittington et al., 1999: 587), allowing them to focus on their core competences (Prahalad and Hamel, 1990). Related to this, interorganizational cooperation can give way to strategic renewal processes that enable organizations to pursue new developments in technologies, products and markets (Crossan and Berdrow, 2003; Lorenzoni and Lipparini, 1999; Volberda, 1996; Volberda et al., 2001). It helps them 'to lower the costs of restructuring and transforming business by facilitating learning,' and it reduces the time to change (Gomes-Casseres, 1996: 45). In this respect, Volberda et al. (2001) demonstrate that external strategic renewal actions, such as initiating strategic alliances and joint ventures, have been more prominent than internal strategic renewal actions within five large financial services for the period between 1990 and 1997. Crossan and Berdrow (2003) convincingly advance that by outsourcing retail, Canada Post Cooperation could develop from a distribution company to an organization focusing on network management. Furthermore, Lorenzoni and Lipparini (1999), in their study of supplier-networks in the Italian packaging machine-building industry, suggest that the ability of companies to interact with other organizations enabled competence renewal and reduced resistance to change. These and other examples show that achieving competitive advantage sometimes becomes inextricably linked to interorganizational cooperation (Dyer and Singh, 1998; Larson, 1992), and that the locus of production is often no longer within the boundaries of a single organization, but occurs instead at a nexus of relationships (Schilling and Steensma, 2001). In fact, 'the very unit of economic behavior is becoming larger than the firm' (Gomes-Casseres, 1996: 5). Accordingly, we are challenged to complement the traditional picture of firm driven production and growth with a view in which interorganizational relationships are used to organize economic activity and to gain competitive advantage (Dyer and Singh, 1998; Koza and Lewin, 1998; Larson, 1992). We also also challenged to gradually replace traditional definitions of the field of strategic management focusing on 'coordination and resource allocation *inside the firm*' (Rumelt et al., 1991: 19) with definitions emphasizing 'coordination and resource allocation both *within* and *across* firm boundaries' (Madhok, 2002: 547).

1.3 Research problem

Thus far, we have concentrated on the virtues of interorganizational cooperation¹. However, interorganizational cooperation exhibits a 'mix of promise and peril' (Fryxell et al., 2002: 866). Although managers 'perceive the need for interorganizational cooperation, they find it difficult to manage those relationships satisfactorily' (Madhok, 1995: 57)². This becomes manifest, for example, when one considers that alliance researchers have reported typical failure rates between fifty and seventy percent (e.g. Harrigan, 1988; Parkhe, 1993a). It appears that many interorganizational relationships do not live up to their expectations (Hoang and Rothaermel, 2005). Problems arise, among others, from inherent conflict, goal divergence, asymmetrical objectives and opportunism by one or more partners (Doz, 1996; Ireland et al., 2002; Kale et al., 2000). Other issues pertain to cultural and organizational differences (Barkema and Vermeulen, 1997; Lane and Lubatkin, 1998; Mohr and Puck, 2005), improper partner selection (Ireland et al, 2002) and deficiencies or breaches of trust (Gill and Butler, 2003). These problems are reinforced by variations in expectations regarding the possibilities for value creation and partner interaction (Inkpen and Beamish, 1997; Madhok and Tallman, 1998; Ring and Van de Ven, 1994). They are further exacerbated by unexpected contingencies, strategic changes by partner organizations and permutations in industries or environments, which may trigger instability (Gill and Butler, 2003; Yan and Gray, 2001), and cause shifts from cooperative toward competitive behavior, possibly leading to the dissolution of relationships.

Park and Ungson (2001) argue that adopting appropriate governance mechanisms may alleviate or mitigate these and other potential problems in interorganizational relationships, as governance mechanisms are means to infuse order, relieve conflict and realize mutual gain (Williamson, 2002). This assertion is supported by, among others, a McKinsey study of more than five hundred alliances involving large U.S., European, Asian and Latin American companies, revealing that many cooperative ventures fail because of unclear decision-making rights (Bamford et al., 2003). It also builds on results from a study on alliances in the drug industry by Accenture (2003), revealing that interorganizational effectiveness frequently suffers from inadequacies in governance and relationship management. Congruently, Ernst (2003) even concludes that about half of alliance failures result from governance issues. In line with this, Takeishi (2001) claims that the issue of how to manage external relationships so as to gain competitive advantage has remained unsolved.

¹ The question of why firms create interorganizational relationships is by now "standard fare" in the literature (Gomes-Casseres, 1996: 13). The general argument is perhaps best represented by Durkheim, who remarked: 'the hardness of bronze lies neither in the copper, nor in the tin, nor in the lead which have been used to form it, which are all soft and malleable bodies. The hardness arises from the mixing of them' (Durkheim, 1982: 39-40).

² In this respect, Gomes-Casseres (1996) advances that cooperation is not a natural act for companies. Everything in their competitive environment, and in their corporate histories, drives them toward win-lose competition and a reliance on internal resources.

Following Park and Ungson (2001), we presume that considerable variation exists in the governance structures applied to interorganizational relationships. Some organizations may, for example, be more skilled than others in designing appropriate coordination and control structures (Anderson and Dekker, 2006). In this respect, Ring (2002: 145) proposes that 'one of the elements that makes some organizations better at forming and sustaining cooperative relationships is that they have a better understanding of the consequences that flow from a need to rely, in part, on contract in the governance of cooperative business relationships.' Madhok (2002: 540) adds that 'governance skills, both within and across firm boundaries, can result in performance differences and competitive advantage.' In line with this, Dyer and Singh (1998) indicate that effective governance might lead to interorganizational competitive advantage, either by lowering transaction costs, or by providing incentives for partner organizations to pursue value creation initiatives, such as investing in relation-specific assets, sharing knowledge, or combining complementary strategic resources. Moreover, Bagley (2005), Ireland et al. (2002) and Mayer and Argyres (2004) note that organizations possessing appropriate governance skills for managing and controlling interorganizational relationships extend their productive opportunity sets. Such organizations are able to address complementary resources and technologies from other organizations (Child and McGrath, 2001; Sanchez and Heene, 1997), and they may be in a better position to renew themselves, as their governance skills enable the internalization of cooperative experiences. In summary, the extent to which gains can be obtained from interorganizational collaboration appears to depend on the appropriate use of governance mechanisms (Sampson, 2004a; Williamson, 2002).

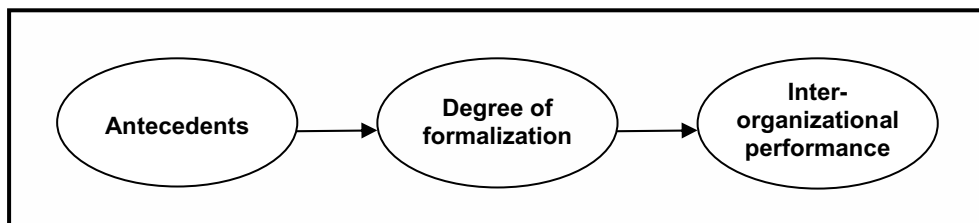
To get those mechanisms right, we need to increase our understanding of the processes that are used to design and manage interorganizational relationships, and of the forces shaping collaborative agreements (Olk and Elvira, 2001; Osborn and Hagedoorn, 1997). This could contribute to improved managerial practices and a reduction in cooperative failures (Barringer and Harrison, 2000). In particular, several authors have pointed at the significance of formalization – provisionally defined as the development and application of contracts, rules and procedures, and the efforts made to enforce those – for interorganizational relationships. Others have asked for a more integrative view on formalization, in which its antecedents and its effects on performance are examined simultaneously, and in which effects of timing and context are incorporated (see Table 1.2). Given these comments, a critical examination of the role of formalization in interorganizational relationships seems timely and warranted. Hence, the focal aim of this study is to address the paramount need for broader and deeper knowledge of the role of formalization in interorganizational relationships. We define the research problem accordingly: *What role does formalization play in interorganizational relationships?*

TABLE 1.2
Significance of and criticism on interorganizational governance (research)

Authors	Citation
Masten & Saussier (2002: 273)	'The growth in the analysis of inter-firm contractual relationships that has occurred in recent years is an indication of the importance economists associate with the issue of contracting and contract design.'
Grandori & Soda (1995: 198)	'...the whole body of literature on networks shows that the extent to which inter-firm relationships are formalized [...] is an important <i>dimension</i> of inter-firm organizing.'
Thatcher (2004: 92)	'The growing enthusiasm for partnerships has created great demand for the skills required to manage them as well as for scholarship that can shed light on what those skills might be.'
Reuer (1999: 13)	'[Deriving value from alliances]... requires companies to select the right partners, develop a suitable alliance design, adapt the relationship as needed, and manage the end game appropriately.'
Zollo & Singh (2004: 6)	'Generally, it might be possible to achieve synergy only when firms carefully design and execute integration processes focused on extracting the gains associated with the combination of the two organizations. Accordingly, [...] it is important to include as explanatory variables the activities necessary to extract those rents.'
Sampson (2004a: 484)	'One possible explanation for this performance difference across alliances is variation in alliance governance; specifically, whether alliance governance is appropriately chosen given the characteristics of the alliance.'
Sobrero & Schrader (1998: 601)	'A first reading of the empirical studies collected for the meta-analysis reveals the absence of an integrated perspective that simultaneously considers the relationships between task characteristics, the contractual and procedural dimensions of inter-firm relationships, and the outcome of the relation.'
Shapira (2000: 64)	'The next step should be a more comprehensive perspective on governance. As Grandori (1997) suggested, it may be less fruitful to attempt to resolve past debates than it is to foster cross-pollination among different perspectives.'
Wright & Lockett (2003: 2074)	'Although examples of collaborative agreements are becoming increasingly common, our understanding of their operation and management does not reflect their expanding role in economic activity.'
Anderson & Dekker (2006: 30)	'...a great deal of work is needed to understand management control practices that are emerging at the blurry boundaries of firms. This work [...] requires the researcher to become conversant in a broader body of business research.'
Stinchcombe (2001: 2)	'Much of the difficulty we have in dealing with formality is that we lack a nuanced definition of what we are talking about, a typology of its varieties, and a theory of the mechanisms by which it is caused and has its effects.'
Colombo (2003: 1226)	'More direct and fine-tuned consideration of the specific coordination and control mechanisms incorporated in different alliances [...] would be very useful to gain further insights.'

To investigate this problem, we first elaborate on the major theoretical perspectives currently prevailing in research on interorganizational governance. We advance that most studies on formalization tend to focus either on its coordination or its control function (Gulati and Singh, 1998; Madhok, 2002; Salbu, 1997). We also contend that they typically inquire into formalization's relationship with antecedents, or into its relationship with performance (e.g. see Anderson and Dekker, 2006; Leiblein, 2003; Sobrero and Schrader, 1998; Stinchcombe, 2001). In general, a first group of inquiries presumes that antecedents of formalization, such as complexity, asset-specificity, or measurability, are associated with the need or the ability to coordinate and control interorganizational behavior and outcomes (Carson et al., 2006; Gerwin, 2004; Helm and Kloyer, 2004). A second category of studies focuses on the relationship between formalization and performance (Sobrero and Schrader, 1998)³. A visual representation of these generic approaches to the research problem is depicted in Figure 1.3.

FIGURE 1.3
Generic framework derived from the literature

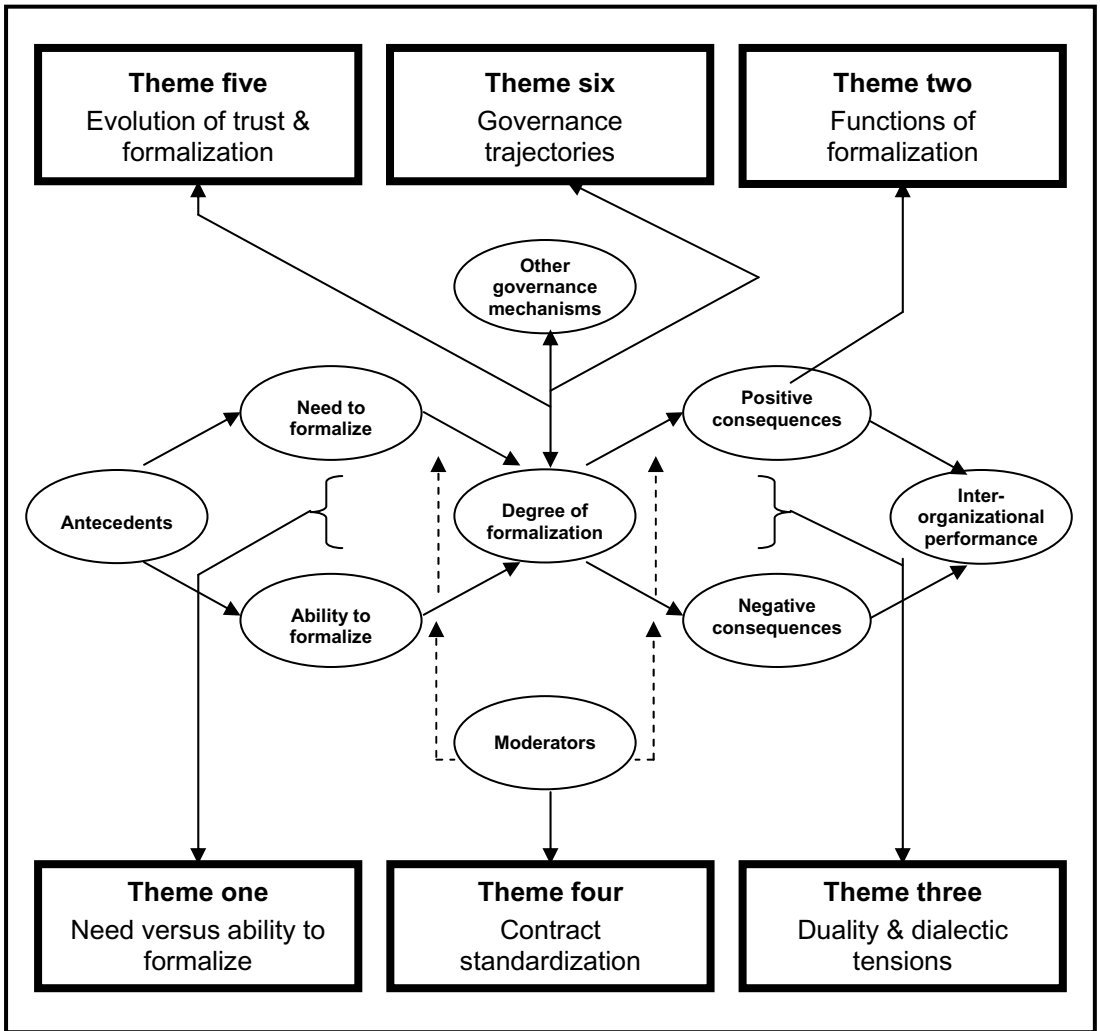


Although the richness and variety of previous examinations has significantly contributed to our understanding, an integrative perspective on the role of formalization in interorganizational relationships has remained absent in the literature so far (Leiblein, 2003; Sobrero and Schrader, 1998; Stinchcombe, 2001). As is the case with research on interorganizational relationships in general (see Oliver and Ebers, 1998), studies on formalization have been built on a cacophony of seemingly heterogeneous concepts, theories and research results, which generally prohibits a clear accumulation of knowledge and conceptual consolidation. In order to establish a less fragmented, disjointed and myopic perspective on the role of formalization in interorganizational relationships, we develop an integrative framework of the research problem, which we depict in Figure 1.4. In this framework, antecedent variables influence the need *and* the ability to formalize. The degree of formalization that results from these seemingly contradictory forces interacts with other governance mechanisms and with moderators, in that formalization is more conducive to certain contexts and stages

³ Research on relational governance suffers from similar problems. Saporito et al. (2004: 400), for example, claims that 'studies of interfirm trust have focused either on its antecedents or its consequences, but not both.'

of interorganizational cooperation, than to others. Finally, we believe that formalization influences interorganizational performance through both its positive and its negative consequences.

FIGURE 1.4
Research framework



Based on the research framework presented in Figure 1.4, we define six research themes that deserve further inquiry. We selected these themes, because each of them promises to extend the generic perspective on formalization prevailing in the literature, and because it functions as an arena for joining two or more theories,

disciplinary fields, or perspectives on formalization. By doing so, we capitalize on a remark by Oliver and Ebers (1998: 573) that 'there might be a greater opportunity for fruitful cross-disciplinary and cross-perspective dialogue than is often realized' in interorganizational research. We also embrace Kogut's (1988) idea that attempts to melt different theories should be encouraged as they facilitate the development of richer, more insightful explanations for interorganizational phenomena. By investigating the research questions connected to each of the six themes, we seek to develop new insights and unite apparently disparate research contributions on the role of formalization in interorganizational relationships. Moreover, we aim to prevent research on formalization in interorganizational relationships from degenerating into a chorus of dissonant voices that cause confusion among researchers and practitioners. Instead, by offering an integrative perspective, we attempt to bring the fragmentation of scholarly discourse to a halt.

1.4 Research themes and questions

The six research themes all build on the generic approach to the research problem presented in the literature, but they also stipulate complementary explanations as to the role of formalization in interorganizational relationships. Each of them focuses on a peculiar part of the research problem, as visualized in Figure 1.4. The order in which they are discussed is far from arbitrary. We have deliberately chosen to start with a theme in which several firm- and relational characteristics are being discussed, which are generally acknowledged to influence the degree of formalization that is being applied in interorganizational relationships. The first theme thereby addresses *when* formalization is likely to occur. In theme two, we subsequently emphasize the functions of formalization, in an attempt to reveal *why* formalization takes place. In theme three, we then investigate *how* formalization influences interorganizational performance. If we highlighted the locations of these research themes in Figure 1.4, one would realize that theme one is situated at the left, and that we move further to the right with themes two and three. It is also clear that we do not touch upon the upper and lower side of the model yet, as these aspects are further removed from the generic model on the role of formalization prevailing in the literature. In theme four, we attenuate the observations from previous chapters, and we highlight that attributes of the *process* of formalization may influence the results from the first three themes. Finally, in themes five and six, we further qualify the observations from previous chapters by indicating that formalization cannot be regarded in isolation, as it is intricately related to other governance forms and mechanisms, such as trust, partner selection and equity payments.

As has been memorized before, the common denominator of the six research themes consists of their focus on intersections. The first theme – on the need and ability to formalize – for example, confronts theories that are primarily concerned with the need to formalize with theories focusing on the ability to formalize. In the second theme – on the functions of formalization – we explore a range of theories attributing distinct virtues to formalization. In theme three – labeled duality & dialectic tensions – we reconcile arguments supporting formalizations functions

and dysfunctions, and we elucidate how managers may cope with their co-existence. Theme four – on contract standardization – unites research on standardization stemming from the contracting and law literature, investigations on interorganizational cooperation emanating from management studies, and inquiries into mindfulness, which derive from cognitive psychology. Finally, in themes five and six, we capitalize on contributions from various research streams to scrutinize formalization's relationships with other governance mechanisms. By combining different theories, disciplinary fields and perspectives on formalization, we subvert 'the provincialism that comes with paradigm confinement' (Gioia and Pitre, 1990: 588) and turn to the production of a more refined and comprehensive view on the role of formalization in interorganizational relationships. In the following paragraphs, we introduce each of the research themes and the research question(s) associated with them.

1.4.1 Theme one – need versus ability to formalize

In theme one, we deviate from the generic perspectives on the role of contracts, rules and procedures in interorganizational relationships by elaborating on the tensions that arise between the *need* and the *ability* to formalize.

In this study, the *need* to formalize indicates that more formalization is requisite, desirable, or useful. The *ability* to formalize concerns one's capacity, competence or position making formalization possible.

We posit that existing studies generally either focus on the influence of antecedents on the need to formalize, or on the influence of antecedents on the ability to formalize (see also Carson et al., 2006; Gerwin, 2004; Kirsch, 1997). In this respect, Carson et al. (2006) suggest that the main part of the literature has paid attention to factors which are presumed to increase the need for formal governance, such as asset-specificity, whereas factors representing the ability to formalize, such as difficulty of measurement or evaluation, have received far less attention (see also David and Han, 2004). In theme one, instead, we capitalize on the observation that the extent to which behavior and outcomes are formalized appears to depend on parties' needs as well as their abilities (Helm and Kloyer, 2004; Kirsch, 1997), and we investigate the concurrent effects of antecedents on both the need and the ability to formalize. This promises to shed light on several contradictory findings emerging from the literature. An example concerns prior cooperation, which is believed to act as a substitute for formalization, because it reduces the *need* for formal governance (Gulati, 1995), and as a complement to formalization, because it raises the *ability* to write more detailed contracts, rules and procedures (Mayer and Argyres, 2004; Poppo and Zenger, 2002). To illuminate this and other apparent contradictions, we pose the following research questions.

RQ1: To what extent do relationships between antecedents and the *ability* to formalize diverge from their relationships with the *need* to formalize?

RQ2: How do the ability and the need to formalize influence the degree of formalization in interorganizational relationships?

1.4.2 Theme two – functions of formalization

Theme two is born out of the observation that most studies on formalization tend to focus on formalization functioning as a means to coordinate, as a means to control, and to a lesser extent as a means to legitimize (see for instance Gulati and Singh, 1998; Kale et al., 2001; Madhok, 2002; Meyer and Rowan, 1977; Salbu, 1997). The mainstream literature thereby generally passes over the fact that formalization might have other functions (for notable exceptions see, for example, Ariño and Ring, 2004; Lindenberg, 2003; Zollo and Singh, 2004).

In this study, functions are defined as ‘observed consequences of social patterns that change existing conditions in the direction of socially valued objectives’ (Blau, 1955: 11).

However, several authors suggest that alternative explanations and novel understandings of formal organizational structures and practices have become imperative (see Table 1.3). Meyer and Rowan (1977), for example, note that coordination and control are not the only functions of formalization. In a similar vein, Hatch (1999) argues that changes in business environments cause traditional understandings of organizational structure to break down, thereby implicitly calling for alternative views on the functioning of formalization in contemporary society. Moreover, Simons (1990) concludes that theorists have to open up the meaning of management control to a broader notion. Like others (e.g. Klein Woolthuis et al. 2005), he stresses that formal “control systems” may be deployed for multiple reasons and purposes.

TABLE 1.3
Demands for alternative explanations of formalization

Meyer & Rowan (1977: 343).	‘Formal organizations are endemic in modern societies. There is need for an explanation of their rise that is partially free from the assumption that, in practice, formal structures actually coordinate and control work’
Hatch (1999: 75).	‘As business becomes more adaptable and flexible in response to shifting demands and opportunities in their globalizing markets, traditional understandings of organizational structure are breaking down’
Simons (1990: 142)	‘Management theorists must strive to understand better the dynamic relationship between strategy and management control processes. This means [...] opening up the meaning of management control to a broader notion...’
Klein Woolthuis et al. (2005: 834)	‘The general conceptualization of contracts as uni-dimensional legal safeguarding instruments is wrong. Our cases show that contracts may have different functions, which can also be social in nature.’

These arguments elicit the question as to whether formalization serves functions beyond coordination, control, and legitimacy. Moreover, if this appears to be the case, one might wonder how the functions of formalization relate to each other and to interorganizational performance (see Luo, 2002; Madhok, 2002), and in which contexts, or in which stages of interorganizational development each of them is most significant. We capture these considerations in the following research questions.

RQ3: What are the functions of formalization?

RQ4: How do these functions relate to each other?

RQ5: What is their relationship with interorganizational performance?

RQ6: What is the relative importance of each of these functions in different collaborative contexts and stages of interorganizational development?

1.4.3 Theme three – duality & dialectic tensions

In theme three, we deviate from the relatively generic coordination and control perspectives on the role of formalization in interorganizational relationships by explicitly considering a duality inherent in formalization (see Das and Teng, 1998). Whereas conventional approaches to the research problem recognize that formalization may have positive consequences or functions and negative consequences or dysfunctions (Mintzberg, 1994; Luo, 2002; Williamson, 1985), they generally presume that managers select the “right” degree of formalization. In that case, formalization matches with organization-level and transaction- or relational level factors in such a way that transaction costs are minimized (Williamson, 1985, 1991), or transaction value is maximized (Foss and Foss, 2005; Madhok, 2002). These studies offer little guidance on how to cope with the tensions that eventuate from the degree of formalization that is actually applied.

In this study, we define dysfunctions as ‘those observed consequences of social patterns that change existing conditions in the direction opposite to socially valued objectives, or consequences that interfere with the attainment of valued objectives’ (Blau, 1955: 11).

In this theme, instead, we explicitly embrace the idea that tensions arising from the co-existence of formalization’s functions and dysfunctions cannot always be solved by spatial or temporal separation (Ring and Van de Ven, 1989), but that they have to be managed (Huxham and Beech, 2003). Likewise, we draw theorizing away from generic perspectives in which formalization is determined by organization- or transaction-characteristics, and we shift towards a perspective in which managerial choice receives more attention (Child, 1997). Such a perspective leaves room for managerial influence and encompasses discussions on how co-existing positive and negative consequences of formalization can be

managed (see Das and Teng, 2000; De Rond, 2003; De Rond and Bouchiki, 2004). It promises to illuminate which trade-offs managers face when they have to decide on the most appropriate degree of formalization for a particular relationship, and how they cope with tensions between the functions and dysfunctions associated with formalization. To elucidate how more attention for managerial choice may enrich our thinking on the role of formalization in interorganizational relationships, we formulate the following research question.

RQ7: How do managers of interorganizational relationships cope with tensions arising from the co-existence of formalization's functions and dysfunctions?

1.4.4 Theme four – contract standardization

Theme four extends generic coordination and control perspectives on the role of formalization in interorganizational relationships with an inquiry into one of the attributes of formalization. It offers an arena for discussing how the common practice of using standard contracts and standard procedures for negotiating and contracting influences the role of formalization in interorganizational relationships.

In this study, we define standard procedures as established methods that are followed routinely (Cohen and Bacdayan, 1994), and that are created and refined over multiple cycles of exchange (Subramani and Venkatraman, 2003).

Although standard contracts and standard procedures for negotiating and contracting are omnipresent (Korobkin, 2003), generic perspectives on the role of formalization in interorganizational relationships do not account for standardization. Apart from some incidental research in law schools (e.g. Epstein, 1999; Goetz and Scott, 1985; Kahan and Klausner, 1996, 1997; Korobkin, 2003), hardly any inquiries are undertaken on this subject. In this theme, we address this imbalance between research and practice by clarifying how standardization influences the role of formalization in interorganizational relationships. We first explain why managers of interorganizational relationships deploy standard contracts and standard procedures for negotiation and contracting. Subsequently, we discuss the disadvantages related to standardizing negotiation and contracting practices. Most notably, we exploit the assumption that the application of standard procedures is accompanied by relatively low degrees of mindfulness (see Langer, 1989; Ryle, 1949). This implies that conventional research models, which build on the coordination and control perspectives on formalization, might have to be adapted. To investigate this issue, we address the following research questions.

RQ8: What are the advantages and disadvantages of using standard contracts in interorganizational relationships?

RQ9: What influence does the introduction of standard procedures for negotiating and contracting have on the generic research model for formalization?

1.4.5 Theme five – the evolution of formalization and trust

In theme five, we assert that most studies in which generic coordination and control perspectives on the role of formalization in interorganizational relationships are adopted pay insufficient attention to the relationship between formal and relational governance. Despite the fact that ‘there is a basic question concerning the role of formal versus informal approaches to the management of’ interorganizational relationships (Heckman, 1999: 142), and that results of existing studies ‘suggest a need to explore more carefully and predict more cautiously the relationship between formal contracts and relational governance’ (Poppo and Zenger, 2002: 721). In particular, the relationship between trust and control remains far from clear (Maguire et al., 2001; Sydow and Windeler, 2003), and much theoretical input is still needed to understand how trust and formalization work as governance mechanisms (Bachmann, 2001).

In this study, trust is defined as ‘the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party’ (Mayer et al., 1995: 712).

More specifically, the role of formalization and trust during the process of relationship development are not well understood (De Wever et al., 2006; Inkpen and Curall, 2004), and little attention has been paid to their evolution in cooperative relationships (for notable exceptions, see Ferrin et al., 2005; Klein Woolthuis et al., 2005; Serva et al., 2005). As a result, practitioners are frequently confronted with conflicting recommendations (see Huxham and Beech, 2003), while academics are left with unclear perspectives on the evolution of formalization and trust in interorganizational relationships. Considering these assertions, this theme investigates the following research question.

RQ10: How do formalization and trust evolve in interorganizational relationships?

1.4.6 Theme six – governance trajectories

Finally, in theme six – labeled governance trajectories – we signal that empirical inquiries that are in line with generic coordination and control perspectives on the role of formalization in interorganizational relationships tend to be rather static, concentrating on only one or a few governance modes in isolation (Geringer and Hébert, 1991a; Kirsch, 1997). These studies tend not to explicitly take into account the fact that governance mechanisms are strongly interconnected. Generally, they either just presume that relationships exist, or they analyse only a few relationships between a limited number of governance mechanisms, such as formalization and prior cooperation (e.g. see Gulati, 1995; Poppo and Zenger, 2002), or formalization and trust (see Luo, 2002). This is at odds with observations that multiple governance mechanisms may have their bearing on

interorganizational performance, and that managers have various governance mechanisms at their disposal for managing interorganizational relationships. Reuer (1999), for instance, contends that potential value creation in interorganizational relationships not only involves appropriate partner selection, but also the adoption of specific interorganizational designs. Moreover, Klein (2002: 62) notes that 'increased contractual specification involves rent-dissipating search and negotiation costs.' Similarly, research on the relationship between formal and relational governance mechanisms (see Gulati, 1995; Luo, 2002; Poppo and Zenger, 2002) gives testimony of the existence of highly intricate and dynamic relationships between different governance mechanisms. This urges Anderson and Dekker (2006) to suggest that an important direction for future research is to investigate larger sets of governance mechanisms simultaneously. In this theme, we therefore establish the concept of governance trajectories.

In this study, governance trajectories are defined as sequences of interrelated decisions that are made to control, direct, or influence the actions and conduct of participants in interorganizational relationships during successive stages of the life-cycle of interorganizational relationships.

We address the disparity between managers facing a large number of presumably interrelated governance choices, and the limited attention that researchers have given to their interconnectedness, by posing our final research question.

RQ11: To what extent are decisions on formalization related to other governance decisions?

1.5 Purpose of the study

The purpose of this study is twofold. First, we seek to develop a more integrative and comprehensive perspective on the role of formalization in interorganizational relationships than is currently envisaged in the literature (Leiblein, 2003; Sobrero and Schrader, 1998; Stinchcombe, 2001). We complement the existing, generic model of formalization, which is based on the coordination and control perspectives, with insights from various theoretical perspectives and backgrounds (e.g. dialectics; sensemaking; mindfulness; law; and, psychology). By doing so, we answer calls for integrative theory development in a chaotic research field (Koza and Lewin, 1998; Osborn and Hagedoorn, 1997). We also enable researchers and practitioners to better define the governance issues with which they are struggling, and we help them to position these issues in a broader perspective.

Second, we purport to close the gap between theories of what people do and observations of their actual behavior (Jarzabkowski, 2004). We address this hiatus by viewing the role of formalization in interorganizational relationships from different angles, and by capturing them in six research themes, each with their own objectives. The objective of theme one – need versus ability to formalize – is to disentangle seemingly paradoxical findings on the relationships between

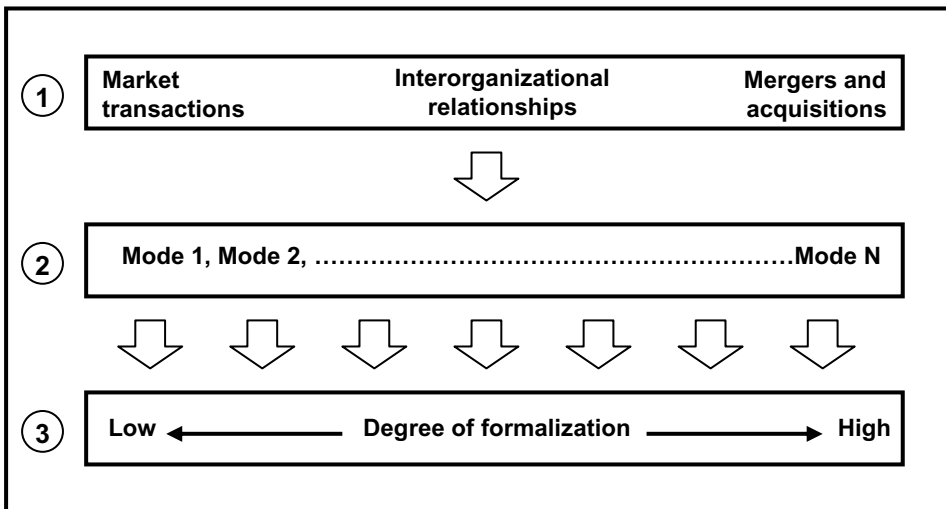
formalization and its antecedents. In discussing the need versus the ability to formalize, we propose that antecedents of formalization that have been advanced by transaction cost economists (e.g. Williamson, 1985, 1991), researchers on prior cooperation (Gulati, 1995; Uzzi, 1997), behavioral theorists and researchers examining dynamic capabilities (Gulati and Singh, 1998) bring about conflicting forces. In light of these theories, we expect that factors like asset-specificity, complexity, a lack of prior cooperation and a small size of buyer organizations aggravate the need for formalization. However, we also believe that these factors concurrently decrease the ability to do so. By exploring this apparent contradiction, we aim to elucidate how organizations deal with the resulting tensions. In our second theme – functions of formalization – we seek to complement views on formalization as being a “means to coordinate”, a “means to control” and a “means to legitimize”. We draw attention to a perspective that has hitherto remained suppositious, in which formalization is viewed as a “means to give and make sense”. By doing so, we can explain why formalization is encountered in cases where, viewed from more conventional perspectives, one would not expect it.

The purpose of theme three – duality and dialectic tensions – is to demonstrate that functions and dysfunctions of formalization are likely to co-exist, and that the resulting tensions have to be managed. By analyzing a case study of an alliance between two multinationals, we show how managers capitalize on these tensions. Our results show the need for reintroducing managerial choice in interorganizational governance research. They also contribute to increasing managerial awareness of the duality inherent in formalization and the possibilities for coping with the tensions that it provokes. The objective of theme four – contract standardization – is to illuminate how the standardization of negotiation and contracting practices, influences the role of formalization in interorganizational relationships. Whereas contract standardization is ubiquitous in interorganizational exchange (see Korobkin, 2003), little academic work is performed in this area. Our review of the advantages and disadvantages of contract standardization serves as a basis on which researchers and practitioners may decide when and whether standardization is appropriate. Theme five – on the evolution of formalization and trust – aims to highlight the salience of and the interplay between both governance forms in interorganizational relationships. By doing so, this theme attenuates views on interorganizational governance that address either formal or relational governance, but not both. The purpose of theme six – governance trajectories – is to illustrate how different governance choices are related to each other. By examining how a number of organization-level and transaction-level factors impinge on various governance choices, and by demonstrating how these governance choices relate to each other, we illuminate that interorganizational management comprises series of governance decisions, which jointly form governance trajectories. Our results indicate that researchers and managers should view interorganizational governance as a dynamic process rather than a static series of decisions.

1.6 Scope of the study

The principal factor used to delineate the scope of this study pertains to the forms by which economic activities can be organized (see step one in Figure 1.5). We exclude pure market-based transactions and vertically integrated forms of organization from our investigations. Consequently, the study is restricted to the role of formalization *in interorganizational relationships*, such as buyer-supplier or outsourcing relationships and strategic alliances. We define these relationships as voluntary initiated formal cooperative agreements between two or more organizations that involve exchange, sharing, or co-development, and that include contributions by partners of capital, technology, or organization-specific assets (e.g. Ariño, 2003; Gulati, 1998; Parkhe, 1993a). Such relationships become pertinent when ‘vertical integration is neither economical nor technically feasible and arms-length transactions cannot meet demands for customization’ (Anderson and Dekker, 2006: 5).

FIGURE 1.5
The organization of economic activity



Partners in such relationships can exert only limited degrees of control (Gomes-Casseres, 1996), and they lose the freedom to act independently (Van de Ven and Walker, 1984). They have to work from a position that combines features of organizations and markets (Stinchcombe, 1985). Although interorganizational relationships remain separate entities, for example, they entail higher degrees of interdependence than market transactions, making the outcome for any party to a transaction ‘fundamentally entwined with the actions of and outcomes for other players’ (Child and McGrath, 2001: 1139). As Figure 1.5 shows, the decision to cooperate is followed by the selection of a collaborative form or cooperative mode.

The key issue here is not whether cooperation takes place, but rather the manner in which a particular relationship is organized (Heide, 1994). Possibilities include, amongst others, buyer-supplier relationships, outsourcing agreements, joint research projects, shared new product development, common distribution agreements, R&D alliances, joint ventures and franchising (Grant and Baden-Fuller, 2004). Finally, when a collaborative mode or form is chosen, partners still have to choose which degree of formalization is appropriate for governing their relationship (Nooteboom, 1999), which is envisaged in step three in Figure 1.5. The focus of this thesis is on the latter issue, which concerns the management and implementation of interorganizational relationships, something which has received little attention compared to the preceding decisions (Sobrero and Roberts, 2002).

A second demarcation of the scope of our study relates to the literature that we use. Following Anderson and Dekker (2006), we refer to theoretical contributions on formalization at the intra-organizational level whenever we believe this is appropriate. Taking such a stance is supported by the fact that interaction within and between organizations shows several fundamental similarities (Gittell and Weiss, 2004; Lorenzoni and Lipparini, 1999), and by the assertion that research on the management of partnerships 'can and perhaps should draw on many conventional managerial nostrums developed with hierarchical organizations in mind' (Thatcher, 2004: 121). It also builds on findings from Gittell and Weiss (2004) and Håkansson and Lind (2004), indicating that various structuring practices commonly adopted within organizations are perfectly adequate for coordination in interorganizational relationships. In their study of healthcare organizations, for example, Gittell and Weiss (2004) conclude that many of the same mechanisms that have been found to be effective in linking units within organizations are also effective for linking activities across organizations. Furthermore, contractual documents used to govern interorganizational relationships are often laced with elements of hierarchy (Stinchcombe, 1985), and collaborative relationships resemble organizations in that they are frequently characterized by their own distinctive organizational systems, rules, routines and norms (Grandori and Soda, 1995; Thatcher, 2004). In line with this, Grandori (2000: 6) even proposes that 'a unitary and general theory of governance – encompassing both [...] internal and external organization – is possible.' Because we also believe that some partnerships have more in common with conventional organizations than much of the literature suggests, we do not refrain from referring to the intra-organizational literature when it helps us in our understanding of the role of formalization in interorganizational relationships.

Nonetheless, we recognize that one cannot completely equate interorganizational structures and structuring practices with their organizational counterparts. There may be important differences between organizing activities in organizations and organizing them in interorganizational relationships, which influence the role of formalization in each. One of the differences playing a role is that organizations contain 'more forces against change.' They are characterized by ingrained interests, established ways of doing things, loyalties among employees, and so on

(Gomes-Casseres, 1996: 85). This may result in situations in which formalization is met with less opposition than if it were applied within organizations. Besides, formalization tends to become imperative for interorganizational cooperation unless parties have previously cooperated with each other, because they have few pre-existing mechanisms for coordination and control at their disposal (Kirsch, 1997), and because a 'tie-breaking authority higher up, and a common ownership interest by which to judge which side provides the greatest contribution' are generally lacking (Gomes-Casseres, 1996: 92). Moreover, participants in interorganizational relationships are more likely to face higher degrees of uncertainty and equivocality compared to their counterparts within organizations. They lack stable and time-tested governance structures, but also face discontinuities in terms of experience, culture, technology and organizational practices. An absence of generic understandings then complicates sensemaking, and influences the structures and structuring practices that they adopt (Clegg et al., 2002a). This is reinforced by the fact that interorganizational relationships tend to occur less frequently and are more heterogeneous than other organizational activities (Reuer and Zollo, 2005).

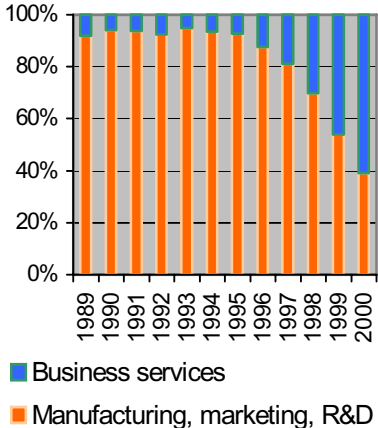
In contrast, the zone of acceptance of authority – defined as the willingness to accept decisions from others (Simon, 1997: 185) – is probably larger for departments cooperating within an organization compared to parties in interorganizational relationships, as the latter can opt out more easily. This may reduce participants' willingness to conform to formalities. In addition, compared to internal organizational units, interorganizational relationships tend to have a much narrower mandate (Reuer and Zollo, 2005), something which reduces the need for formalization. Finally, formalization is only one of the many means by which control can be achieved in interorganizational relationships (see Klein Woolthuis et al., 2005). Participants may use other governance mechanisms, which have little significance when activities are organized within organizations, such as efforts invested in partner selection, or equity exchange. These differences between organizing activities in organizations and organizing activities in collaborative relationships have to be kept in mind, as they may influence the role of formalization in interorganizational relationships. The differences between partners in interorganizational relationships, for example, may influence the balance between the need and the ability to formalize (theme 1), and they possibly increase the significance of some functions of formalization at the cost of others (theme 3).

1.7 Empirical basis

The unit of analysis in our research is the interorganizational relationship. Congruent with this, the empirical basis for the study consists of interorganizational relationships involving at least one services organization, being an IT-organization, a financial institution, or a retail organization. Our focus on services organizations is born out of the relative silence in previous research on interorganizational relationships including these types of organizations, and the increasing tendency towards external cooperation by such organizations. Recent

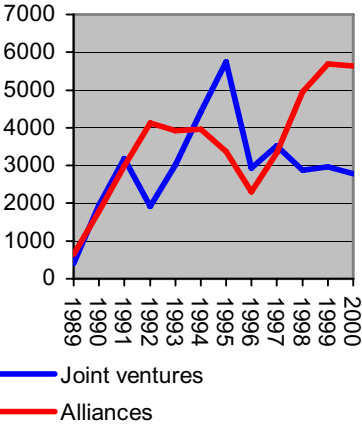
figures of the OECD, for example, demonstrate that alliances involving services activities absorb a strongly growing share of total worldwide alliance activity compared to manufacturing, marketing and R&D activities (see Figure 1.6). More specifically, the number of interorganizational cooperative relationships involving services organizations in 2000 was more than five times as high than in 1995 (Kang and Sakai, 2001). In our empirical investigations, we further restrict ourselves to non-equity relationships, as it is now recognized that interorganizational cooperation increasingly takes place in less hierarchical forms. Although earlier research tended to concentrate on the choice between equity and non-equity forms of cooperation (Grandori and Soda, 1995; Heiman and Nickerson, 2004; Oxley, 1997; Reuer and Ariño, 2003), the relative importance of joint ventures compared to alliances is declining sharply (see Figure 1.7). Hagedoorn and Osborn (2002) even ascertain that the percentage of joint ventures in newly established R&D partnerships declined from ninety percent in 1970 to less than ten percent in 1998.

FIGURE 1.6
Purpose of alliances worldwide



Source: Kang and Sakai, 2001

FIGURE 1.7
Number of joint ventures & alliances



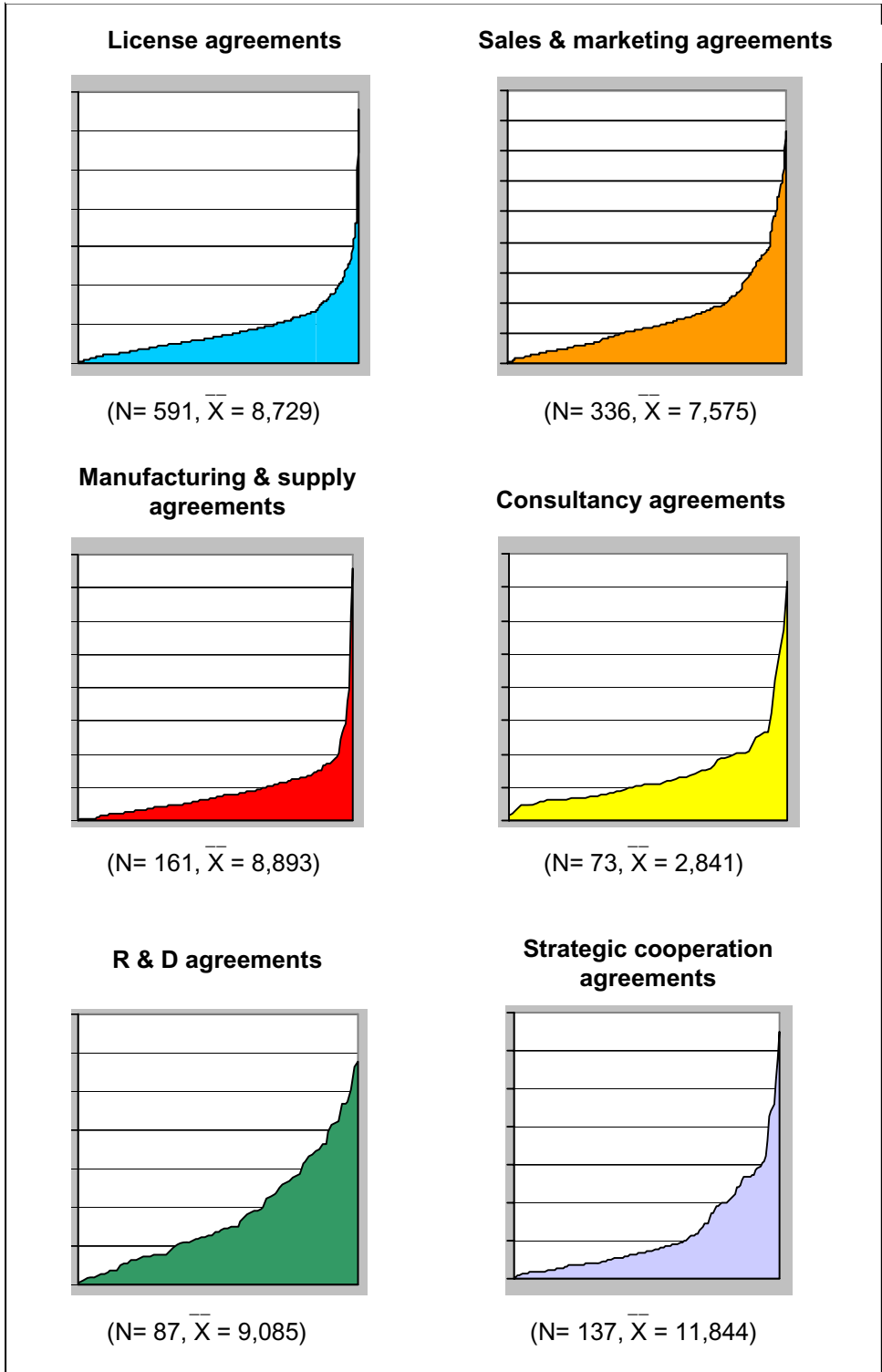
Source: Kang and Sakai, 2001

Although our focus is on interorganizational relationships involving services firms, we do not focus on one particular form of relationship. Although we investigate a strategic alliance between a major European-based retailer and a globally acting financial service organization, we also inquire into a large number of buyer-suppliers relationships involving purchases of IT-solutions. We thus deploy a kind of empirical pluralism, seeking progress 'by applying basically the same set of theoretical principles to a broad class of empirical phenomena...' (Buskens et al., 2003a: 5). We argue that this approach is warranted by the fact that formalization seems to play a role in almost any kind of interorganizational relationship, ranging

from licensing agreements to strategic alliances. An indication of the significance of formalization for different types of interorganizational agreements can be derived from the length of the contracts adopted in these relationships (Hill and King, 2004). Below, we present examples of contract lengths for 591 license agreements, 336 sales and marketing agreements, 161 manufacturing and supply agreements, 73 consultancy agreements, 87 R&D agreements and 137 strategic cooperation agreements, which were obtained from onecle.com. A simple word-count for each of the contracts, followed by a sorting procedure by which relationships are ordered according to ascending contract length leads to Figure 1.8. Descriptive statistics (see Appendix A) reveal that contract length in this convenience sample ranges between 217 and 75,608 words. Mean values differ significantly between types of relationships, with consultancy agreements having the lowest value and strategic cooperation agreements displaying the highest value. The large differences in contract lengths, even within different categories of relationships, support the core assumption in our research that there is considerable variation in the degree of formalization that is being used.

FIGURE 1.8

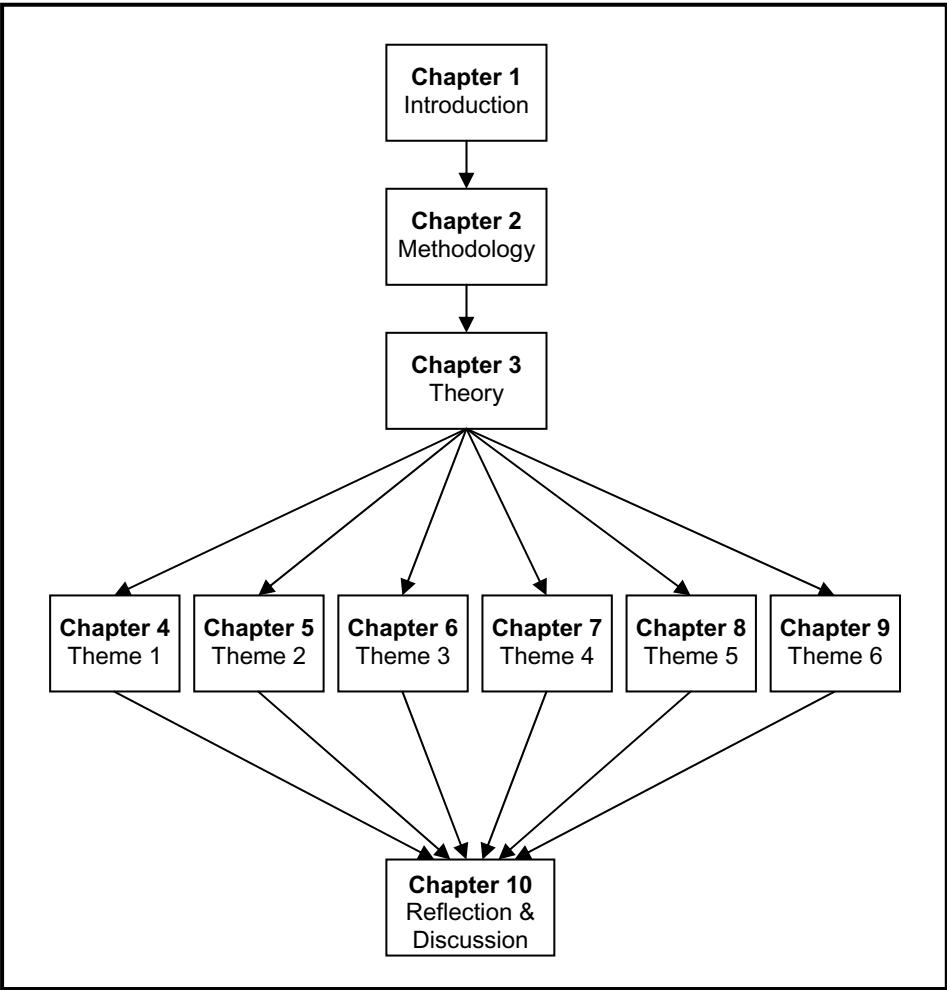
Distribution of contract length (# words) for different kinds of agreements



1.8 Structure of the study

In this paragraph, we present a brief outline of the structure of the study (see Figure 1.9). The purpose of the first chapter was to introduce the research problem and the research questions forming the basis of this thesis. In the second chapter, we elaborate on the most common theories used to shed light on the role of formalization in interorganizational relationships. We start by providing definitions and typologies of formalization and interorganizational performance. Subsequently, we discuss various theories underlying the relatively generic coordination and control perspectives on the role of formalization in interorganizational relationships.

FIGURE 1.9
Structure of the study



In chapter three, we explain the methodological position that we adopt in the study, and we offer insights into the approaches that will be taken to tackle the research questions. We advance that a thorough understanding of the role of formalization in interorganizational relationships demands a pluralistic methodological stance, in which case study and survey methods can be used to address different parts of our research problem. These methods help to illuminate different research questions and they shed light on different facets of the research problem. In chapter four to nine, we comply with Osborn and Hagedoorn's (1997) request to abandon singular, clear-cut descriptions of interorganizational cooperation and we replace them with a more robust, sophisticated, multidimensional vision. In these chapters, we explore each of the six research themes that were identified in chapter one. The chapters are all written along similar lines, in that they start with a description of the theme's relationship to the research problem and the research framework presented in Figure 1.4. The introductions are followed by descriptions of possible enrichments of, and complements to, the generic coordination and control perspectives on the role of formalization in interorganizational relationships (as described in chapter two). In themes one, four and six we test our hypotheses on a sample of 911 buyer-supplier relationships. Themes two and four contain theoretical contributions, as the research questions posed in these themes are highly exploratory and multifaceted in nature, which precludes large-scale empirical testing. In theme three, we analyze a case study, as this method is most appropriate for developing new insights on the managerial actions that are undertaken to cope with tensions resulting from formalization. In chapter ten, we contemplate a synopsis of the theory developed and the key findings emanating from the case study and the survey-data. Following this, the theoretical and practical implications of the study are expounded, after which the limitations of the study and possibilities for future research are being addressed.

1.9 Conclusion

In this chapter, we have set the stage for a study on the role of formalization in interorganizational relationships. We started by explaining the growing significance of interorganizational cooperation, and argued that formalization – in the form of contracts, rules and procedures – could contribute to improving interorganizational performance. To investigate when formalization is appropriate, why it is being used, and how it affects interorganizational performance, an integrative perspective on the role of formalization in interorganizational relationships is needed, something which is still absent in the literature. In order to address this issue, we devised an integrative research framework and identified six research themes that assist us in addressing the research problem. We then emphasized the purpose and scope of our inquiry, and we discussed its empirical basis. Finally, we explained the structure along which we conduct our investigation. In the following chapter, we elucidate how some of the major research streams in the literature on interorganizational governance view the role of formalization in interorganizational relationships.

2 THEORY: COMMON PERSPECTIVES ON FORMALIZATION

'While different theoretical perspectives or paradigms may be irreconcilable in their own philosophical terms, when applied to the study of organizational phenomena they are not necessarily incommensurable.'

Child, 1997: 44

2.1 Introduction

In this chapter, we develop definitions and typologies of the concepts of formalization and interorganizational performance. Subsequently, we describe how two of the major research streams in the interorganizational governance field view the role of formalization in interorganizational relationships. We label those relatively generic views the "coordination" and "control" perspective, and suggest that the first perspective draws its arguments from the behavioral theory of the firm and from research on dynamic capabilities, whereas the second perspective builds upon transaction cost theory and agency theory. By describing these generic perspectives, the chapter aims to elucidate how we tend to look at the role of formalization in interorganizational relationships. The chapter serves as a basis, or platform, for discussing each of the research themes, which build on and complement the coordination and control perspectives depicted here. Although we believe that the different theoretical perspectives or paradigms that we describe in this chapter and the remainder of the thesis may be irreconcilable in their own philosophical terms, we agree with Child (1997: 44) that 'when applied to the study of organizational phenomena they are not necessarily incommensurable.'

2.2 Definition and typology of formalization

In order to illuminate the role that formalization assumes in interorganizational relationships, a clear definition is due. Most concepts ending in "-tion" are ambiguous with regard to process and outcome – 'between the way one gets there, and the result' (Baum and Rowley, 2002: 1). This also accounts for formalization, which both refers to the process of codifying and enforcing inputs, outputs and behaviors (Ouchi and Maguire, 1975; Ouchi, 1979), and to the outcomes of this process in the form of contracts⁴, rules and procedures (Hage and Aiken, 1966). The distinction between formalization as a process and formalization as an outcome becomes obvious when one considers contractual planning – a principal form of formalization in interorganizational relationships. Contractual planning aims at maximizing value creation, while it recognizes the fact that motives of transaction parties necessarily differ and that coordination is required to receive information and to assign rights, obligations, risks and revenues (Hill and King, 2004). It consists of the 'process of projecting exchanges into the future' (Macneil, 1980: 4), and includes defining performance, duties and

⁴ Bozeman and Kingsley (1998) explain that project documentation, change requests forms, or notes of staff meetings can also serve as contracts, as they protect participants from risks and control their behavior.

rights in future circumstances; defining what should happen when parties do not hold to agreements; and assessing in how far the contract can be legally enforced (Macaulay, 1963). This *process* of contractual planning eventuates in promises or obligations to perform particular actions in the future (Macneil, 1980), which are recorded in formal contracts, representing formalization as an *outcome*.

Both forms of formalization have two components, being codification and enforcement (e.g. Hage and Aiken, 1966). Codification conveys that explicit, systematic procedures are involved (Pearce II et al., 1987), which help to create perceptual and conceptual categories that facilitate the classification of phenomena (Boisot, 1998). It refers to explicitly recording or writing down aspects of inputs, outcomes and/or behavior. Enforcement, instead, signifies that codified agreements are “in force”. It permits parties to make believable promises to each other, so that the execution of agreements can ultimately be exacted (Schwartz and Scott, 2003)⁵. Enforcement does not necessarily mean that partner organizations are “forced to comply”. It implies that they act with the process of formalization and its outcomes in mind. It seldom takes place by actually appealing to courts or authority⁶. Instead, the sheer existence of these sources for ultimate appeal already allow for compliance to formalities by partner organizations (Galanter, 1981; Salbu, 1997; Williamson, 1999)^{7, 8}. Agreements can also “be in force” because parties want to avoid ruining relationships and reputations, or because it is simply most cost efficient (Antia and Frazier, 2001; Elfenbein and Lerner, 2003; Klein, 2002). Absent these considerations, situations in which formalities are not being contemplated should not be labeled formal (Stinchcombe, 2001). To recap, we offer the following definition of formalization.

⁵ On a macro-economic level, limited enforceability of contracts impairs the efficient allocation of resources. It also results in greater volatility of outputs, and it delays the diffusion of new technologies (Cooley et al., 2004). There are no reasons to believe that similar effects do not apply to interorganizational cooperation. When firms are not able to guarantee a certain extent of compliance to agreements by potential partners, they will refrain from initiating relationships altogether, or they are handed over to the whims of their partner, which potentially results in more variable expected outcomes of the relationship.

⁶ Authority is defined here as ‘the power to make decisions which guide the actions of another’ (Simon, 1997: 74). This power is ‘recognized as so vested, and [...] accepted as appropriate not only by the wielder of power but by those over whom it is wielded and by the other members of the system’ (Katz and Kahn, 1966: 203).

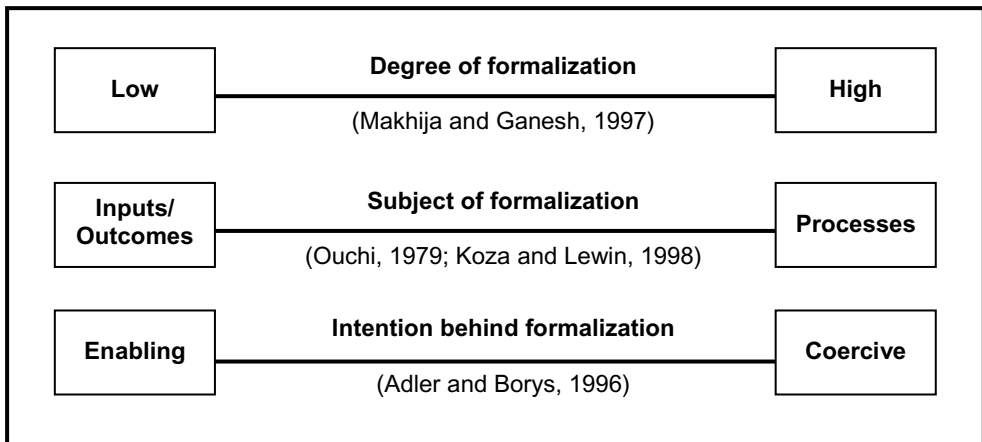
⁷ The threat of retaliation will generally deter non-compliance to agreements. From a control perspective, possibilities for legal enforcement only need to deal with states in which payoffs for deviations from the norm are very high (Eggleston et al., 2000).

⁸ Friedrich’s “rule of anticipated reactions” seems to be valid here, which suggests that expectations and anticipations govern behavior (Simon, 1997: 182). Potential disputes, including many that under current rules could be brought to a court, are frequently resolved by avoidance, self-help, and the like (Galanter, 1981).

Formalization concerns the *process* of codifying and enforcing inputs, outputs, and behavior (Ouchi, 1979), and the *outcomes* of this process in the form of contracts, rules, standard policies, procedures, and regulations (Hage and Aiken, 1966).

Next to a definition, we develop a typology of formalization, which comprises three attributes (see Figure 2.1). The first and most obvious attribute refers to the degree of formalization applied in interorganizational relationships, ranging from high to low. This attribute is still most commonly used by researchers (Makhija and Ganesh, 1997). The second attribute pertains to the extent to which formalization applies to inputs and outcomes, or to processes (e.g. see Ouchi and Maguire, 1975; Ouchi, 1979; Koza and Lewin, 1998; Stinchcombe, 2001). Finally, the third attribute covers the degree to which formalization has an enabling or a coercive character (e.g. see Adler and Borys, 1996). As the last two categorizations are the least straightforward, we pay most attention to these attributes, starting with the distinction between the formalization of inputs and outputs, and the formalization of processes. This distinction derives from the work of Katz and Kahn (1966), Simon (1947, 1997) and Stinchcombe (2001), who have examined these concepts on an intra-organizational level. Katz and Kahn (1966: 298), for example, propose two major categories of policy-making: ‘the formulation of organizational goals and objectives, and the formulation of strategies and procedures for achieving and assessing progress towards such goals’. In a similar vein, Simon (1997: 307) contends that someone ‘may be told what to do, but given considerable leeway as to how [he or she] will carry out the task’. Stinchcombe (2001: 51) refers to this distinction by stating that ‘abstract versions of procedures and technologies may be formulated in terms of their outcomes [...], or by the sequence of actions that are thought to reliably produce the best results...’

FIGURE 2.1
Three attributes of formalization



The formalization of expected outcomes of a relationship concerns the clarity with which goals are set and with which the scope of the relationship is delineated (Cyert and March, 1963; Cheng and Van de Ven, 1996). It entails the inclination, determinedness, and means to be able to hold on to this scope, and work according to the goals set earlier on (McGrath, 2001). Formalization of inputs and outcomes further refers to the codification and enforcement of *what* is to be accomplished (e.g. scope, goals), and by *what means* this has to be done. Formalization of processes, instead, entails the coordination and adjustment of activities of interdependent parties (Sobrero and Schrader, 1998). It also encompasses the specification and supervision of operational or post-formation activities (McGrath, 2001), so that control can be exerted over these (Burns and Stalker, 1961). When process formalization is high, contracts or other documents specify, for example, terms and clauses concerning how to set up the relationship, how to operate and manage the relationship, and how to cooperate and resolve conflict between partners (Luo, 2002). Formalization of processes thus refers to the codification and enforcement of *how* outcomes are to be realized⁹.

The third attribute for categorizing different types of formalization concerns the intention behind formalization. In this respect, Adler (1993: 165) has noted that ‘subsequent generations of researchers have tended to focus on the punishment-centered form and the associated compliance logic of bureaucracy’ and the processes associated with it, such as formalization. In his famous article on the NUMMI joint venture between General Motors and Toyota, however, he concludes that the performance effects of formalization depends on whether it is designed to enforce compliance or to enable cooperation. In a later paper on the formalization of workflows in an intra-organizational context, Adler and Borys (1996), distinguish enabling types of formalization – designed to enable employees or partner organizations to master their tasks – from coercive types of formalization – aimed at coercing effort, forcing reluctant compliance, and displacing opportunism¹⁰. Formalization thus appears to relate, ‘on the one hand, to the constitution of meaning, and on the other to the sanctioning of modes of social conduct’ (Giddens, 1984: 18). The purpose of the enabling type of formalization is to achieve ‘coordination and higher levels of understanding’ (Zollo and Singh, 2004:

⁹ The distinction between the formalization of inputs and outcomes, and the formalization of processes is theoretically important but empirically hard to make. Ultimately, formalization is exercised to change behaviors (Kirsch, 1997; Ouchi, 1979). Simon (1997: 39) clarifies that there is no essential difference between a desired outcome and a process, but only a distinction of degree. A process is an activity whose immediate purpose is at a low level in the hierarchy of means and ends, while a desired outcome is a collection of activities whose aim is at a high level in this means-end hierarchy.

¹⁰ The resemblance between this distinction and the two kinds of bureaucracy described by Max Weber is striking. Weber wrote about a “representative” form of bureaucracy, based on rules established by agreement, rules which are technically justified and administered by specially qualified personnel, and to which consent is given voluntarily. However, he also described “punishment-centered” bureaucracies, which are based on the imposition of rules, and on obedience for their own sake (Gouldner, 1954: 24).

16). It involves motivating participants in interorganizational relationships (Lindenberg, 2003), and requires flexibility (Adler and Borys, 1996). Parties have to be open to each other's requests to modify a prior agreement, and they should rather work out a new deal than hold each other to the original terms when some unexpected situations arise (Bello and Gilliland, 1997). Enabling types of formalization also require involvement of parties to the agreement during the formalization process, and managerial encouragement concerning the formulation of improvements (Adler and Borys, 1996). The distinction between coercive and enabling types of formalization is meaningful as formalization's effectiveness might vary with regard to the manner in which rules are initiated, whether by imposition or agreement. After all, we prefer 'agreed-upon, rather than imposed rules...' (Gouldner, 1954: 20). Participants in interorganizational relationships may receive contracts, rules and procedures that are devised to enable cooperation differently from their coercive counterparts.

2.3 Definition and typology of interorganizational performance

The second major construct in our study concerns interorganizational performance. Defining and measuring interorganizational performance is a difficult issue (Ariño, 2003; Geringer and Hébert, 1991b; Gray, 2000); a precise and consistent definition of collaborative success and failure is still lacking, and the diversity of measures that have been used is high (Mohr and Puck, 2005; Yan and Gray, 2001). Olk (2002) indicates that researchers have tried to make sense out of the breadth of performance measures that are available in several ways. First, they have empirically evaluated the compatibility of various measures (e.g. Ariño, 2003; Geringer and Hébert, 1991b; Glaister and Buckley, 1998; Hagedoorn and Cloudt, 2003). Second, they have argued that the appropriateness of different performance measures varies among contexts (Yan and Gray, 1995) and research questions (e.g. Gulati and Zajac, 2000; Reuer and Koza, 2000). Finally, they have developed conceptual frameworks to organize different approaches to interorganizational performance measurement (e.g. Gray, 2000; Olk, 2002; Park and Ungson, 2001). Table 2.1 serves as an example of such a conceptual framework. Another illustration is provided by Olk (2002), who utilizes studies on organizational effectiveness to organize different approaches to performance measurement. Olk indicates that performance can be measured on two levels of analysis: the level of the relationship itself and the level of the partner organizations (see also Gray, 2000; Yan and Gray, 1995). Besides, he advances that one may distinguish performance measures by their purpose or approach. He contends that in an optimization approach, all parties use a single criterion for evaluation. In a strategic interest approach one goal prevails as well, but a dominant coalition may use several representative measures, and goals may change. In a multi-interest approach, there are multiple evaluators of interorganizational performance, which use different and sometimes conflicting criteria. Finally, in the sequential perspective, multiple criteria are used for evaluation, which are assumed to be temporally related (Olk, 2002).

TABLE 2.1
Overview of performance measures in alliance studies

Measure	Authors	Failure rate	Operational definition
Relational level:			
Survival (stability)	Franko (1971)	24%	Liquidation/ownership change
	Tomlinson (1970)	50%	Termination
	Killing (1983)	30%	Liquidation/Reorganization
	Kogut (1988)	46%	Termination
	Beamish (1987)	45%	
	Porter (1987)	50%	Divesture
	Harrigan (1988)	55%	
	Park & Russo (1996)	67%	Dissolution/Acquisition
Duration	Harrigan (1988)		Alliance age
	Kogut (1988)		
	Park & Ungson (1997)		
Financial performance	Tomlinson (1970)		Return on investment
	Raffii (1978)		Alliance Returns
Subjective index	Killing (1983)	36%	Poor-Good
	Beamish (1987)	61%	Mutual Agreement
	Harrigan (1988)	55%	Mutual Agreement
Composite index	Parkhe (1993a)		
Partner level:			
Achievement	Hamel et al. (1989)		Conceptual
Learning	Hamel (1991)		Case Studies

Source: adapted from Park and Ungson, 2001

Although categorizing interorganizational performance measures can be helpful in selecting performance measures for empirical studies, it does not mitigate the drawbacks that are associated with individual measures. All measures of interorganizational performance appear to have their own problems. Relationship mortality, for example, does not account for the fact that termination may indicate that partner organizations have attained their strategic objectives, or that they exit a relationship in a better competitive shape (Das and Teng, 2000; Gulati, 1998). It also does not consider the fact that organizations may pursue an options strategy to accomplish their objectives, in which they develop large portfolios of relationships, from which only one or a few need to be successful to prosper (Vassolo et al., 2004). In such cases, termination of a relationship may hinge on the comparative benefits generated in other relationships. Moreover, it does not make allowances for gradations of performance (Gulati, 1998), although 'it is only realistic to expect alliances to fail in some respects (e.g. attaining original purposes) and to succeed in others (e.g. generating spin-offs)' (De Rond, 2003:

9). In addition, continuation of a relationship is not always in the partner's best interest (Reuer and Koza, 2000), as becomes apparent from a comment issued by the divisional president of a US firm, who ended a long-standing joint venture with a Japanese firm. He indicated that 'although the partnership was sound and the alliance had been very successful, the alliance no longer fits with firm strategy' (Inkpen and Li, 1999: 35). Another example concerns performance measures assessing the degree to which strategic interests of cooperating organizations are accomplished. Criticism of these measures centres on the fact that they are perceptual (Olk, 2002), and that objectives may change over time (Gill and Butler, 2003). Besides, such measures are confronted with validity problems, due to a deficiency of common objectives, and the co-existence of multiple strategic objectives (De Rond, 2003; Larson, 1992; Yan and Gray, 1995).

Another problem with many performance measures is their focus on outcomes of relationships. Lately, several researchers have stressed that new insights may be drawn by shifting our focus from solely measuring outcome performance to a view in which process performance measures are included (Ariño, 2003; Kumar and Nti, 1998). These measures can capture the fact that participants in interorganizational relationships might simply appreciate collateral experiences such as a bold move or a good meeting (March, 1999), and they could account for the fact that they do not only judge results, but also the intentions behind the behavior of others (Chaserant, 2003). Support for the significance of process performance is afforded by De Rond (2003), who found that assessments of interorganizational performance and success in two alliances between pharmaceutical and biotechnology firms were based not solely, or even primarily, on rational (e.g. economic or strategic) considerations, but rather on cognitive processes of individuals in these alliances. A definition of interorganizational performance should therefore both capture outcome and process performance. Outcome performance then captures the effectiveness and efficiency of a relationship, including the degree of overall performance satisfaction, the presence of net spill-over effects, the extent to which strategic goals are fulfilled, and parties' adherence to schedules and budgets (see Ariño, 2003; Hoang and Rothaermel, 2005). Process performance, instead, pertains to the relational quality of cooperative endeavors. It entails things such as the ease or smoothness of cooperation (Luo, 2002), the extent to which conflicts prevail in the relationship, and partners' satisfaction with coordination and communication processes (Poppo and Zenger, 2002). We adopt a definition of interorganizational performance that captures both aspects.

Interorganizational performance concerns 'the degree of accomplishment of the partners' goals, [...], and the extent to which their pattern of interactions is acceptable to the partners' (Ariño, 2003: 23)

Outcome performance and process performance may influence each other (Kumar and Nti, 1998; Zajac and Olsen, 1993), and they may even be inseparable (Parkhe, 1993b). Researchers have suggested, for example, that 'the pattern and

quality of interaction between partners throughout the life of the [alliance] relationship determines the value created' (Madhok and Tallman, 1998: 333). Findings from Ariño (2003), and Hagedoorn and Cloodt (2003) support this assertion, suggesting that managers may need no complex metrics to evaluate interorganizational performance, as these measures are highly correlated. Accordingly, we refer to both processes and outcomes when discussing interorganizational performance in this study.

2.4 Formalization and interorganizational performance

Evidence on the relationship between formalization and interorganizational performance is mixed and narrow (Jap and Ganesan, 2000; Sobrero and Schrader, 1998), something which might stem from the fact that different performance measures are being used in different analyses (Sobrero and Roberts, 2001, 2002). The most one can say is that the relationship between formalization and interorganizational performance is likely to follow a curve-linear path, where too little formalization gives rise to chaos and where too much formalization leads to rigidity and a loss of creativeness (Katz and Kahn, 1966; Luo, 2002; Mintzberg, 1994; Scott, 2003). In this respect, Mintzberg (1994: 386) notes that 'formalization is a double-edged sword, easily reaching the point where help becomes hindrance.' The influence of formalization on interorganizational performance has further been argued to be contingent on the stage of development of a relationship (Jap and Ganesan, 2000), on the type of relationship or the collaborative context (Oxley, 1997; Sampson, 2003) and on the aim managers have in mind when formalizing their relationship (Madhok, 2002). In addition, formalization may have distinct effects on a range of performance measures (Sobrero and Roberts, 2001, 2002), and these effects may be contingent on whether formalization is of an enabling or a coercive kind (Adler and Borys, 1996), and on the extent to which it pertains to outcomes or processes (Ouchi and Maguire, 1975; Ouchi, 1979, 1980). Moreover, formalization may entail numerous functions, but also a range of unintended consequences that affect performance (Blau, 1955). Furthermore, formalization interacts with other governance mechanisms that moderate its influence on performance. Finally, formalization is only one of the variables among a myriad of factors and processes affecting interorganizational performance (Beamish and Berdrow, 2003). It is therefore not an easy task to establish a univocal relationship between formalization and interorganizational performance.

2.5 Major theoretical perspectives on formalization

Now that the major constructs in this study have been defined, we pay attention to the most common and influential theoretical perspectives in the literature describing the role of formalization in interorganizational relationships. We group the main theories on this topic into two broad categories: (1) the ones focusing on formalization as a mechanism for coordination, and (2) the ones viewing formalization as a means to control (e.g. see Gulati and Singh, 1998; Madhok, 2002; Salbu, 1997). This distinction is warranted by comments from several highly credited researchers. Gulati and Singh (1998: 811), for example, advance that

'firms choose governance structures both to manage anticipated coordination costs and to address appropriation concerns.' Dyer and Singh (1998: 88) add that employing 'governance mechanisms that lower transaction costs or permit the realization of rents through the synergistic combination of assets, knowledge, or capabilities' both contribute to achieving interorganizational performance and competitive advantage. Formal rules thereby have an incentive function, preventing conflicts and opportunistic behavior, and a coordination function, comprising elements that bring together individual actions to meet a defined set of goals (Avadikyan et al., 2001). The coordination and control perspectives thus focus on problems from fundamentally different origins, with control problems being rooted in differences in motivation and interest, and coordination problems arising from the cognitive limitations of individuals (Gulati et al., 2005). As the difficulties that partners may experience in aligning each other's actions can persist even though the partners' interests may be aligned, both arguments emphasizing coordination as well as arguments stressing control for explaining the structuring and performance of interorganizational relationships are valid, and they deserve to be discussed separately (Gulati et al., 2005; Salbu, 1997). Consequently, we distinguish theories that refer to problems of coordination from theories emphasizing problems of control to explain the role of formalization in interorganizational relationships.

2.5.1 Coordination perspective

Coordination refers to 'the organization of goals, priorities, and programs for the future, the ordering of the desires and expectations between or among the transacting parties, and the adjustment of individual behaviors to accommodate the schedules and functions selected for mutual endeavor' (Salbu, 1997: 332). Partner organizations may experience difficulties in aligning each other's actions, which may hamper the realization of interorganizational rents (Dyer and Singh, 1998; Gulati and Singh, 1998). They therefore require coordination mechanisms that help them to decompose tasks, and to establish and communicate the activities that have to be completed (Gulati and Singh, 1998). In this sense, contracts, rules and procedures can be interpreted as technical aids to managing relationships, sometimes 'in the same way that minutes of a meeting remind participants of arrangements that were made' (Klein Woolthuis et al., 2005: 835). The coordination function of formalization is of particular significance for interorganizational relationships in which tasks have to be continually geared to each other and for which joint decision making between interorganizational partners is required (Gulati and Singh, 1998).

Support for the coordination function of interorganizational structuring arrangements is provided by Gulati et al. (2005), Mayer and Argyres (2004), and Ryall and Sampson (2004). In their analysis of 222 procurement relationships at the automobile producers Chrysler and Ford, for example, Gulati et al. (2005) found that different modes of organizing procurement relationships differed not only in the ability to control hazards of opportunistic behavior, but also in their capacity to generate coordinated responses to adaptive pressures in the task and

transaction environment. In their study of technology alliance contracts, Ryall and Sampson (2004) noted that contracts often embodied non-enforceable clauses that appeared to serve coordination functions only. They assisted in planning the collaboration, setting partner expectations, and reducing misunderstandings and unintended consequences. The coordination function of formalization further receives support from findings by Lassar and Kerr (1996), who revealed a highly significant correlation (0.34, $p < 0.05$) between the extent to which contractual restrictions were imposed on distributors by manufacturers of audio speakers, and the level of coordination that they attempted to realize for five different distributor activities. In addition, Gulati and Singh (1998) found that for a sample of 1570 alliances announced between 1970 and 1989, governance structures were not only influenced by appropriation concerns, but also by anticipated coordination costs arising from task interdependence and complexity. As these citations indicate, the coordination function of formalization is highly significant in many cooperative relationships. This is reinforced by the fact that 'management information and control systems are invariably much less developed across organizations than they are within them' (Thatcher, 2004: 112), rendering formalization the primary means to institute coordination. In the following paragraphs, we briefly discuss theories focusing on formalization as a means to coordinate, including March and Simon's theory of organizational behavior, and the dynamic capabilities view.

March and Simon's theory of organizational behavior

March and Simon's theory of organizational behavior outlines the processes through which formalization contributes to rational behavior in organizations, and to limiting the negative effects of bounded rationality (March and Simon, 1958; Simon, 1947, 1997). From the perspective of organizational behaviorists¹¹, formalization enables coordination by supporting rational decision making, 'not only by parcelling out responsibilities among participants, but also by providing them with the necessary means to handle them' (Scott, 2003: 52). Specialized roles and rules, and standard operating procedures are viewed as mechanisms that restrict the range of decisions organizational participants make, and that assist participants in making appropriate decisions within that range (Scott, 2003). Moreover, as ultimate goals of organizations can be vague and imprecise, general

¹¹ Although our inquiries do not explicitly refer to the work of Max Weber, organizational theorists like March and Simon have built on his insights. We therefore briefly outline some of his thoughts here. Weber focuses on the replacement of traditional organizational structures with bureaucratic structures. He points at general administrative policies and specified procedures, which enable bureaucratic systems to handle complex administrative tasks (Scott, 2003). Weber argues that formal rules considerably contribute to organizational efficiency. He explains that formalities restrict organizational members' room for egoistic maneuvers and arbitrary decisions, and that rules control organizational processes, increase their predictability, and enable the division of labor (Beck and Kieser, 2003). 'Bureaucracy is superior, explains Weber, to other historically known forms of administration, because of its stability, reliability, the calculability of results which it permits, and the large scope of its operations' (Gouldner, 1954: 25).

goals serve as starting points for raising means-ends chains in which goals and the means to achieve these goals are subdivided into sub-goals and sub-means until a sufficient level of detail is attained (March and Simon, 1958). In this way, formalization enhances procedural coordination. It establishes the lines of authority, and outlines the sphere of activity and authority of each member (Simon, 1997), so that the division of labor and interactions between partners become more predictable.

In other words, by clarifying boundaries on activities and decisions, formalization simplifies decision-making (Galbraith, 1977). It serves the purpose of enabling communication, reducing uncertainty about future tasks, and preventing disputes on how to achieve tasks (Pondy, 1977). Other arguments for the coordination function of formalization, which implicitly or explicitly refer to the work of March and Simon, emphasize that formalization gives rise to clear expectations of participants in interorganizational relationships (Organ and Greene, 1981; Shenkar and Zeira, 1992; Simonin, 1999), and that it helps to translate complex interorganizational issues into 'terms that are clear and understandable' (Simon, 1997: 345). In addition, formalization reduces the interdependence and complexity of activities as perceived by participants in interorganizational relationships (Singh, 1997), and renders coordination less dependent on individual actors (Scott, 2003), thereby enabling personnel replacements and participation of newcomers in later stages of development (De Rond, 2003). This also reduces the risk that things are "forgotten" (Argote, 1999; Mintzberg, 1994). Finally, formalization frequently entails a common language (Simons, 1990), which enables participants in relationships to communicate their goals, and to signal each other's preferences (Milewicz and Herbig, 1996).

Dynamic capabilities

A second stream of research pointing at the coordination function of formalization consists of the dynamic capabilities school. Building on the resource-based view, proponents of this school maintain that organizations can be regarded as bundles of resources (Rumelt, 1984), and that valuable, rare, imperfectly imitable, and imperfectly substitutable resources can become sources of sustainable competitive advantage (Barney, 1991; Peteraf, 1993). Organizations can capture value from combinations of these resources over longer periods of time when they are protected by isolating mechanisms (Rumelt, 1984), time compression diseconomies to imitation (Dierickx and Cool, 1989), or when causal ambiguity prohibits copying by competitors (Lippman and Rumelt, 1982). From this perspective, value is created and rents are earned through the efficient and effective development, deployment, allocation, exchange, and utilization of resources (Lado et al., 1997). Interorganizational relationships can thus form an avenue for the sustained earning of rents by enabling the synergistic combination of resources from different organizations (Dyer and Singh, 1998; Madhok and Tallman, 1998).

In order to realize this synergistic potential, partner organizations have to bundle their relevant resources and capabilities effectively (Ghoshal and Moran, 1996).

This prompts the incurrence of expenditures for effecting and managing resources, and it requires capabilities from partners to actively manage resources in order to extract value from them (Madhok and Tallman, 1998). This is often not an easy task as resources of partner organizations are frequently embedded and distributed throughout their organizations, and because many resources have a tacit or causally ambiguous character (see Madhok and Tallman, 1998; Simonin, 1999). Combining these resources requires partners to gear interdependent tasks to each other (Colombo, 2003; Gulati and Singh, 1998; Kogut, 1988; Ring and Van de Ven, 1992), something presenting unique coordination challenges (Sampson, 2004b; Grandori and Soda, 1995). Mechanisms for addressing these challenges could include a clear definition of authority relations, allocation of formal responsibility for decision-making, and the creation of standardized procedures and rules (Colombo, 2003). To make sure that these mechanisms are only applied in cases where this is appropriate, partner firms require managerial capabilities associated with the formation and management of interorganizational relationships (Gulati, 1999; Mayer and Argyres, 2004). These capabilities help them in 'adapting, integrating, and reconfiguring internal and external organizational skills, resources, and functional competencies' (Teece et al., 1997: 515). They enable them to overcome the considerable challenges associated with forming and managing interorganizational relationships (Gulati, 1999).

The dynamic capabilities school suggests that resource- or organization-specific characteristics determine cooperating organizations' preferences for particular governance structures to coordinate their activities (Chen and Chen, 2003; Leiblein, 2003). The term dynamic refers to a firm's capacity to renew these competencies, so as to achieve congruence with regard to changes in the collaborative environment, in the relationship, and in the partner organizations themselves. In line with this, Madhok (2002) suggests that the reason that firms organize similar transactions in different ways is that it is not just transaction particulars that matter, but also organizational particulars, including resources, governance skills, experience, and the like. This shifts the emphasis away from the best generic institutional form for organizing a particular transaction towards the best way for a specific firm to organize such a transaction (Williamson, 1991; Madhok, 2002). Adherers to the dynamic capabilities school thus affirm the possibility that some organizations are more inclined to formalize their relationships than others, irrespective of the task characteristics in these relationships. Stated otherwise, 'different firms have different propensities to cooperate and [they] also differ in how they cooperate' (Madhok, 2002: 543). Organizations may differ in their ability to select attractive sourcing partners, negotiate, and enforce supplier contracts, design systems to manage relationships, or to monitor and enforce contractual compliance (e.g. Doz and Hamel, 1998; Leiblein and Miller, 2003).

Some organizations, for example, have been found to be more experienced in managing joint ventures (e.g. Anand and Khanna, 2000a), more capable of interacting with other companies (Lorenzoni and Lipparini, 1999), or more capable of creating value by means of interorganizational relationships (e.g. Dyer et al.,

2001). These companies develop alliance capabilities, relational capabilities, or cooperative competencies (e.g. Draulans et al., 2003; Dyer and Singh, 1998; Dyer et al., 2001; Kale et al., 2002; Sivadas and Dwyer, 2000), and they learn how to gain access to and transfer knowledge across alliances (Lorenzoni and Lipparini, 1999). In their study of 469 make-or-buy decisions involving 117 semi-conductor firms, Leiblein and Miller (2003), for instance, demonstrate that the greater the number of prior outsourcing relationships with suppliers of a particular technology, the more likely it is that firms decide to outsource in subsequent make-or-buy decisions. Here, the asymmetric distribution of alliance managerial capabilities, due to, among other aspects, prior experience, encourages some firms to exploit them as a source of competitive advantage (Dyer et al., 2001).

Both March and Simon's behavioral theory and the dynamic capabilities school emphasize difficulties associated with combining resources (Teece et al., 1997). Each of them concurs that the need for coordination becomes higher when transactions entail higher degrees of complexity (see also Colombo, 2003; Gulati and Singh, 1998; Heiman and Nickerson, 2004). Furthermore, behavioral theory suggests that larger sizes of the cooperating organizations complicate interorganizational coordination and that the age of cooperating organizations might influence their inclination to formalize (March and Simon, 1958; Simon, 1947, 1997). Older organizations probably experience a higher degree of institutionalization of procedures for interorganizational cooperation. They might have developed internal coordination capabilities, which can possibly be extended across organizational boundaries (Gittell and Weiss, 2004). Moreover, from a dynamic capabilities point of view, one could argue that the possession of more legal expertise would lead to higher degrees of formalization, as the ability to formalize would rise. A similar argument could be advanced for the influence of experience with formalization obtained from other interorganizational relationships (see Bagley, 2005; Mayer and Argyres, 2004).

2.5.2 Control perspective

The "control perspective" on the role of formalization in interorganizational relationships alludes to the fact that efforts to control outcomes and behavior extend beyond the legal boundaries of individual organizations (Otley et al., 1995). It refers to the fact that partners wish to 'ensure that the other in a relationship will perform in accordance with one's desires or expectations' (Salbu, 1997: 332). Following Ouchi (1979, 1980), control is therefore defined as the process by which one entity influences the behavior and output of another entity. It encompasses all attempts to ensure that participants in interorganizational relationships, being organizations as well as individuals, act in a manner that is consistent with meeting the goals and objectives set in these relationships (see Kirsch, 1997). Control likewise involves the identification and specification of acceptable behaviors or outcomes, and it concerns the evaluation of actual outcomes and behavior (Eisenhardt, 1985; Kirsch, 1997).

Advocates of the control perspective presume that gaining partial control over a partner organization is important, as interests of partners rarely coincide (Blumberg, 2001; Buskens et al., 2003a), and because partners are confronted with information asymmetry (see Fama and Jensen, 1983; Lassar and Kerr, 1996; Shane, 1996). Such differences between partners offer fertile ground for opportunistic behavior (Carson et al., 2006; Williamson, 1985, 1991), and they imply that any attempt to collaborate – however promising – contains the seeds for its own destruction (Gill and Butler, 2003). Solutions to the problems indicated by proponents of the control perspective consist of formalization and monitoring. Contractual safeguards, for example, are thought to curb opportunism and raise the costs of self-interested activities by changing pay-off structures and incentives (Lui and Ngo, 2004; Lassar and Kerr, 1996), and by increasing the transparency of relationships and of the objects of monitoring (Reuer and Ariño, 2002). Authors emphasizing the control function of formalization primarily draw support from transaction cost economics and agency theory.

Transaction cost theory

Prior research on formalization in interorganizational relationships ‘has been primarily influenced by transaction cost economists’ (Gulati, 1998: 302). From a transaction cost economics view (TCE), governance is defined as ‘the measures the actors involved in exchange use or implement in order to mitigate the risks associated with economic exchange’ (Buskens et al., 2003a: 2). TCE explains the use of formal governance mechanisms, such as contracts, by pointing out the risks to which partners in interorganizational relationships are exposed, and the costs that they have to incur to delimit those risks. The theory builds on several assumptions, including the belief that man is boundedly rational (Simon, 1947, 1997) and that human beings may behave opportunistically (Williamson, 1985). The first assumption – bounded rationality – concerns the fact that ‘it is impossible for the behavior of a single, isolated individual to reach any high degree of rationality. The number of alternatives he must explore is so great, the information he would need to evaluate them so vast that even an approximation to objective rationality is hard to conceive.’ The human mind simply cannot ‘bring to bear upon a single decision all the aspects of value, knowledge, and behavior that would be relevant’ (Simon, 1997: 92, 117). Simon therefore argues that people’s behavior is rational, *given* their goals, the information they possess, and their cognitive impediments. The latter diminishes their ability to foresee contingencies, potential problems, and actions of partner organizations. Human beings thus strive for rationality but are restricted in doing so, leading Simon (1997: 88) to contend that behavior is ‘*intendedly* rational, but only *limitedly* so.’ Given bounded rationality, it is impossible to specify every possible contingency in a formal document (Anand and Khanna, 2000a; Williamson, 1985).

The second assumption of TCE concerns the likelihood that partners in interorganizational relationships exhibit opportunistic behavior. Williamson (1985: 47) refers to opportunism as ‘self-interest seeking with guile’. Underlying the assumption of opportunism is the idea that cooperating organizations do not have coinciding interests, and that they simultaneously cooperate and compete (Adair

and Brett, 2005; Ireland et al., 2002; Hamel, 1991; Kale et al., 2000; Khanna, 1998; Zeng and Chen, 2003). As the primary loyalty of participants in interorganizational relationships generally lies with their own organization (Hult et al., 2004), and because the optimum outcome for one partner is not the optimum for the other (Simon, 1997), frictions may arise. This implies that interorganizational relationships are, per definition, fraught with tensions (Madhok, 1995). Williamson puts adverse selection and moral hazard forward as examples of opportunistic behavior. Adverse selection implies that potential partners in interorganizational relationships may communicate incomplete or distorted information on purpose, in order to make sure that they become a preferred partner or can transact against beneficial conditions. Moral hazard refers to the difficulty with which parties to a contract can infer ex post what the performance of each organization has been in relation to the transaction. Williamson (1985) does not argue that all organizations or participants involved in interorganizational relationships behave opportunistically, but he notes that there is always a chance that they do so, which gives rise to the need for formal safeguards. This implies that, however honest and dutiful partners may be, they are not entirely free of self-seeking behavior (Hendry, 2002), and they may act against the interest of their partners when the benefit of doing so is large enough. To recap, transaction costs economists believe that transactions are organized so that they 'economize on bounded rationality while simultaneously safeguarding [them] against opportunism' (Williamson, 1985: 32).

TCE advances that the governance of transactions entails transaction costs, comprising: (1) search costs, (2) contracting costs, (3) monitoring costs, and (4) enforcement costs (Hennart, 1988; Williamson, 1985). Search costs include the costs of gathering information to identify and evaluate potential partners. Contracting costs refer to the costs of negotiating and writing an agreement. Monitoring costs include costs made to ensure that each party fulfills predetermined sets of obligations. Finally, enforcement costs refer to the costs connected with ex post bargaining and sanctioning of a partner that does not perform according to agreement (Dyer, 1997). TCE has defined several attributes of transactions, such as investments in relation-specific assets, uncertainty, and transaction volume and/or frequency, which impinge on these transaction costs. We limit ourselves here to discussing the effect of conducting investments in transaction or relation-specific investments, as this effect has received most empirical support (David and Han, 2004). Asset-specificity refers to durable investments undertaken in support of particular transactions, for which the opportunity costs are much lower than in best alternative uses or by best alternative users, should the transaction be prematurely terminated' (Williamson, 1985: 55). As asset-specificity increases, redeployability diminishes, and contracting hazards become magnified (David and Han, 2004; Klein et al., 1978; Subramani and Venkatraman, 2003). For parties that have performed such investments, switching to another partner becomes more costly, and termination of the relationship inevitably results in an irrevocable loss of their specific investments (Heide and John, 1988). These organizations are also anxious about the use of their investments as hostages by partners, making it difficult for them to

recoup their value (Jap and Ganesan, 2000). Solutions to the difficulties posed by idiosyncratic investments lie in the deployment of appropriate control mechanisms, such as contracts (Dyer, 1997; Jap and Ganesan, 2000; Williamson, 1985)¹². To summarize, TCE assumes that parties are boundedly rational and that they may behave opportunistically. This gives rise to a need for governance, which becomes larger for relationships in which parties have invested more in transaction- or relation-specific assets. The need to install governance mechanisms that curb ex post bargaining and hold-up threats¹³, and that help to ensure that partners make efficient ex ante investments (Williamson, 1985) then has to be weighed against transaction costs (Heide, 1994). The managerial focus from a TCE perspective is thus on limiting vulnerability to opportunistic behavior by partners by choosing governance structures that minimize the costs of doing so (Williamson, 1991).

Although transaction cost economics has contributed significantly to our understanding of interorganizational cooperation, it has also received criticism. TCE has been argued to erroneously treat each transaction as an independent event (Doz and Prahalad, 1991), and to neglect the social environment and the interconnectedness of transactions (e.g. Batenburg et al., 2003; Granovetter, 1985). TCE also discounts the fact that transaction “costs” have the character of investments – with outlays and benefits spread out over a succession of periods (Furobotn, 2002). Furthermore, TCE has been criticized for its normative implications, which may entail self-reinforcing cycles of increasing opportunism, possibly harming organizations’ performance (Ghoshal and Moran, 1996). Besides, TCE focuses on cost minimization of a single party, despite the fact that a relationship ensues between multiple partners, and it stresses cost minimization over value maximization (Zajac and Olsen, 1993), and control over coordination (Gulati, 1998), although organizations seem to take both value creation and value-claiming decisions into account when forming interorganizational relationships (Heiman and Nickerson, 2004). Moreover, transaction cost theory is a school of thought in which transactional attributes alone determine firms governance design

¹² We believe a qualification should be made here. Investments in relation-specific assets entail the potential to create considerable value for both parties within an interorganizational relationship. These returns might be sufficiently large to discourage opportunistic behavior by the party that “receives” the investments. To the extent that the specialized assets produce greater than normal returns for the receiver, they may therefore create a self-enforcing contract for the investor (Rokkan et al., 2003), and render formal governance mechanisms to curb opportunistic behavior superfluous.

¹³ The risk of hold-up occurs when partners with malicious intent can use the court to enforce literal contract terms in a manner contrary to the intent of the contract. This is one of the primary economic lessons from the General Motors – Fisher Body Case. In that case, Fisher took advantage of the long-term, cost-plus exclusive dealing contract with GM, as it refused to locate an important body plant next to the GM assembly plant after signing the contract. As a consequence, Fisher produced very costly (but highly profitable) automobile bodies that General Motors was compelled to buy (Klein et al., 1978; Klein, 2000). The General Motors – Fisher Body example illustrates that increased contractual specification can make things worse (Klein, 2002).

choices and the efficiency of interorganizational relationships (e.g. Colombo, 2003), resulting in a rather mechanistic view regarding the origins of formalities (e.g. see Child, 1997), in which organizational attributes and capabilities are ignored (Madhok, 2002).

Agency theory

A second theory supporting the control perspective on formalization is labeled agency theory. This theory originally described the relationship between the owners of organizations, so-called principals, and their employees or agents (Berle and Means, 1932). Nowadays, it is used to identify areas of divergent interest and means used to align those interests. Agency theorists now focus on agency problems, which might occur in any situation involving cooperative efforts between two or more parties that have different goals and that require a certain division of labor (Jensen and Meckling, 1976). Its major strength lies in its focus on the reasons for disagreement between interdependent actors, and on the means by which it is resolved (Lassar and Kerr, 1996). Agency theorists suggest that agency problems arise because principals cannot determine if agents will behave or have behaved appropriately. Just like TCE, agency theorists elaborate on moral hazard – referring to a lack of effort on the part of an agent, which is hard to detect by the principal – and adverse selection – where an agent misrepresents its skills or abilities, which are again hard to verify by the principal – to explain the need for formal governance. Similarly to TCE, agency theorists attempt to determine the most efficient solution for governing relationships, given assumptions about people (e.g. self-interest, bounded rationality, and risk aversion), interorganizational relationships (e.g. conflict among participants), and information (e.g. information is a commodity that can be purchased). They attempt to explain whether, and when behavior-oriented contracts are more efficient than outcome-oriented contracts by posing a trade-off between the cost of measuring and programming behavior and the cost of measuring outcomes and transferring risk to the agent (Eisenhardt, 1989b). Agency theory's dichotomous choice between process-based or outcome-based contracts aligns with Thompson's (1967) and Ouchi's (1979) linking of known means-ends relationships with behavior control and connecting crystallized goals to outcome control (Eisenhardt, 1989b). That is, known mean-ends relationships (task programmability) are predicted to lead to behavioral control, and crystallized goals (measurable outcomes) are predicted to lead to outcome control (Eisenhardt, 1989b). When the costs of monitoring agent behaviors are high, the more efficient contract is outcome-based (Lassar and Kerr, 1996), and vice versa. Table 2.2 presents an overview of variables affecting the efficiency of behavior-based and outcome-based contracts.

In addition to describing the relationship between employees and owners of an organization, agency theory is used for analyzing all kinds of relationships 'that mirror the basic agency structure of a principal and an agent who are engaged in cooperative behavior, but have differing goals and differing attitudes towards risk' (Eisenhardt, 1989b: 59). Its application also pertains to interorganizational relationships (Fama and Jensen, 1983; Lassar and Kerr, 1996; Shane, 1996), as partner organizations in such relationships experience conflicts of interest, and

information asymmetry. Manufacturers, for example, make trade-offs between the amount of control required in their distribution channels and the levels of resource commitment and risk they are willing to bear (Lassar and Kerr, 1996). It is frequently not obvious to organizations, for instance, as to how large the actual costs incurred by their partners are, and which benefits from the relationship exactly accrue to them. Furthermore, they do not always have a clear image of the efforts their partners put into the relationship, while partners may also abuse the responsibilities delegated to them (see Alchian and Demsetz, 1972), or consume resources and rents beyond what has been agreed on (see Jensen and Meckling, 1976). One of the solutions to these problems advocated by agency theorists consists of the formulation of contracts between principals and agents (Berle and Means, 1932; Jensen and Meckling, 1976). Other related means to reduce these problems are bounding and monitoring (Fama and Jensen, 1983). Through bounding, principals receive information from agents on their efforts and on the outcomes achieved. Monitoring prompts a more active role from the principal, as it encompasses supervision and checking of an agent's efforts and the outcomes accomplished by the principal.

TABLE 2.2
Agency theory: Behavior-based versus outcome-based contracts

	Behavior-based contract is efficient when:	Outcome-based contract is efficient when:
Monitoring:		
Monitoring ability	High	Low
Task observability	High	Low
Clarity of outcome measures	Low	High
Relationship:		
Goal conflict	Low	High
Length of relationship	Long	Short
Risk:		
Outcome certainty	Low	High

Source: Lassar and Kerr, 1996

Although agency theory and TCE display many similarities, they differ as to the independent variables that they use for explaining observed degrees of formalization. Whereas transaction costs economics emphasizes variables such as asset-specificity and frequency and volume of transactions, agency theorists refer to outcome uncertainty, behavioral uncertainty, and programmability of behavior. Moreover, 'while there exist a number of studies that have tried to test transaction cost analysis against empirical reality, this is much less true for agency theory' (Swedberg, 2003: 378). Nevertheless, there is support for principal-agent hypotheses linking contract form with outcome uncertainty, outcome measurability, and task programmability (Eisenhardt, 1989b). According to Eisenhardt, progress

in agency theory is most likely to stem from expansion towards richer and more complex contexts, inclusion of a broader range of contract alternatives, and use of complementary theories or perspectives.

We believe that both the coordination and the control perspective have offered valuable insights. However, we also signal that these perspectives are predicated on the tenets of only a few major paradigms (Gioia and Pitre, 1990), which might lead to illusive explanations, and to erroneous prescriptions for practitioners (see Adler, 1993; Huxham and Beech, 2003). A focus solely on these perspectives probably does not do justice to the multifaceted nature of the concept of formalization. In other words, we believe that these perspectives are helpful, but insufficient to illuminate the role of formalization in interorganizational relationships. Consequently, we are 'forced to crisscross paradigms' (Narayandas and Rangan, 2004: 64), and to develop multiple perspectives on our research problem, instead of an "all-encompassing" theory (see Grant and Baden-Fuller, 2004: 62; Adler, 1993: 172). In the following chapters, we therefore build on the coordination and control perspectives presented here, but we also seek to join them with competing and complementary views. Such a theoretically pluralistic approach is known to have the capability of uncovering rich explanations of complex phenomena (Kumar and Seth, 1998), and to bring 'ample opportunity for cross-perspective dialogue and learning' (Oliver and Ebers, 1998: 570). In doing so, we cherish the fact that interorganizational relationships are studied from different disciplinary approaches, and that they offer 'a precious ground of common interest and potential dialogue among various branches of the social sciences' (Grandori and Soda, 1995: 183). Our pluralistic approach to investigating the research problem in chapter four to nine should therefore not be viewed as a search for the truth, but more as a search for comprehension, in which different worldviews are illuminated (Gioia and Petri, 1990; Lewis and Kelemen, 2002). By viewing our research problem from multiple angles, we are able to draw a more differentiated and refined, but also more coherent and comprehensive picture of the role of formalization in interorganizational relationships than is currently available in the literature.

2.6 Conclusion

In this chapter, we have discussed how two main streams in research on interorganizational governance look upon the role of formalization in collaborative relationships. We started by developing definitions and typologies of the constructs that are central to this study, after which we reviewed several theories supporting the "coordination" and "control" perspectives on the role of formalization in interorganizational relationships. Both perspectives presuppose that certain antecedents influence the need or the ability to formalize, eventually determining the degree of formalization in interorganizational relationships. In chapters four to nine we seek to complement the dominant views in the literature that have been sketched here, so as to provide a more comprehensive and nuanced image of the role of formalization in interorganizational relationships.

3 METHODOLOGY

'If people have multiple identities and deal with multiple realities, why should we expect them to be ontological purists? To do so is to limit their capability for sense making.'

Weick, 1995: 35

3.1 Introduction

In this chapter, we discuss the ontological and epistemological predispositions that shape our approach to conducting research. We advance that the adoption of a pluralistic stance as a way of looking at the nature and relations of being and as a way of gaining knowledge about these is most appropriate for investigating the research problem. Although we realize that 'multiparadigm researchers live in a glasshouse open to attack' from researchers tied to single paradigms (Lewis and Kelemen, 2002: 259), we believe that adopting such an approach offers a more comprehensive, nuanced and accurate picture of the role of formalization in interorganizational relationships than could otherwise be achieved. Building on this pluralistic basis we explain why case study as well as survey methods are used to investigate the research questions advanced in chapter one.

3.2 Methodological pluralism

Weick (1995: 35) asks himself why we should expect people to be ontological purists. He claims that doing so limits 'their capability for sense making.' His comment refers to the fact that working from a single ontological paradigm frequently 'produces a potentially valuable, but narrow view, incapable of exposing the multi-faceted nature of organizational reality' (Lewis and Kelemen, 2002: 268). Deploying single conceptual lense to understand complex phenomena, such as formalization, genereally leads to erroneous conclusions, something that became very evident in Allison's (1971) seminal work "Essence of Decision" in which he analyzed the Cuban missile crisis in terms of three alternative frames of reference. McKelvey (1997) therefore proposes to study organizations as quasi-natural phenomena. From his point of view, organizations – or in this case interorganizational relationships – are composed of numerous structures and processes that are amenable to natural science methods of inquiry and justification logic, including prediction, generalization, and falsifiability. Nevertheless, they also comprise behaviors directly attributable to human intentionality – behaviors and causes that are much harder to understand in terms of natural science methods. Accordingly, different methods – accompanied by different methodological presuppositions – are regarded as being suitable for answering different kinds of research questions (e.g. Yin, 1994), and for making 'accessible different sorts of information' (Azevedo, 2002: 730). Congruent with this, we adopt a pluralistic or multi-paradigm approach.

We justify the adoption of such a methodological pluralist perspective by the fact that we purport to establish an integrative perspective on the role of formalization

in interorganizational relationships. By working from a pluralistic methodological stance, we reduce the risk that we highlight only one aspect of the phenomenon that we study (Knudsen, 2003; Mintzberg and Lampel, 1999) and we are able to provide a richer understanding than any one approach by itself (Van de Ven and Poole 2005). It also enables us to study a great number of theoretical alternatives simultaneously, and to provoke discourse and inquiry across a number of paradigms (Lewis and Kelemen, 2002), each highlighting different facets of the phenomena (Gioia and Pitre, 1990). A pluralistic approach may thereby offer a more reliable guide to action than inquiries based on single paradigms (Volberda and Lewin, 2003).

Our approaches for studying formalization in this thesis can be classified according to the typology of Van de Ven and Poole (2005). These authors distinguish ontological views of “organization as things” from ontological views of “organization as processes”. They also discern “variance” and “process” epistemologies. This renders a two-by-two matrix of possible research approaches to studying particular organizational phenomena. As our definition of formalization in the previous chapter indicates, our ontological viewpoint covers contracts, rules and procedures (formalization as nouns, real entities or things), as well as the process of formalization (formalization as a process of organizing). We believe these viewpoints are inseparable and have to be investigated in concert. Moreover, where Van de Ven and Poole (2005) contend that researchers use variance methods or process narratives for their inquiries, we use both perspectives in this thesis. We believe that a methodological perspective in which natural science methods are advocated is the most suitable point of departure for answering the research questions posed in themes one, four and six, which respectively deal with “the need versus the ability to formalize”, “contract standardization”, and “governance trajectories”. We deem such an approach useful for these three themes, because we attempt to explain formalization and other variables by lawful regularities here. In doing so, we do not presume that such regularities dominate human agency (Voss, 2003), but we assume that these regularities can be distinguished despite the existence of human agency, something which indicates a mechanistic approach to organizational analysis (Child, 1997). We thus emphasize formalization’s role as a programmer of social conduct, which acts on agents like a force of nature, and which compels interorganizational participants to behave in a particular way (see Giddens, 1984). Adopting such an approach allows us to investigate the research questions posed in themes one, four and six by means of large-scale data-analysis¹⁴.

¹⁴ This approach to research has not remained free of criticism. Piore (1995: 63), for example, notes that the basic problem of this methodological stance is its commitment to an individualist ethos and its inability to recognize and accord a legitimate place to organic groups and cohesive social organizations.⁷ Others signal that it leads to the lack of attempts to seek out underlying causes or generative mechanisms of observed phenomena. The most notable criticism of such an approach centres on (1) its conceptualization of agency, (2) its inattentiveness to meaning, and (3) the relations it presumes between structure and agency (Chia, 1997). Considering the first point, researchers adopting this approach presume that the question of what an agent “does” coincides with his or her “intentions”

Instead, we concur that the research questions in themes two, three and five demand a research approach that is better able to offer insight into individuals' unique interpretations of the phenomenal world, of their attributions of causality to events surrounding them, and of interpretations, social constructions, and sense makings of others' behaviors (Chia, 1997). Such an approach entails a process-based ontology, which 'opens up the possibilities for rethinking "organization", or in this case formalization, as a process of "world-making" (Chia, 1997: 685), or as 'a ceaseless process of reality construction and maintenance that enables us to carve out our otherwise amorphous life-worlds into manageable parts so that we can act purposefully and productively amidst a flood of competing and attention-seeking stimuli' (Chia, 2003: 136). Adopting such an approach enables us to inquire into functions attached to the process of formalization and into the ways in which managers cope with the tensions that are brought about when contracts, rules and procedures are applied. Particularly in theme two – on the functions of formalization - we draw 'the logic of organizational theorizing away from structured entities, outcomes, and end-states, towards the underlying thought-structuring processes, which produce these outcomes' (Chia, 1997: 703). By embracing the concepts of sensegiving and sensemaking, we describe formalization in terms of structuring processes and practices (Hatch, 1999), which entail the transformation of thought and meaning in individuals (Chia, 2003)¹⁵.

(Giddens, 1984). However, the knowledgeability of human actors is always bounded on the one hand by the unconscious, and, on the other hand, by unacknowledged conditions or unintended consequences of action (Giddens, 1984; McKinley and Scherer, 2000; Weick, 1995). The second critical note refers to the fact that it keeps theories and findings of the social sciences wholly separate from the universe of meaning (Giddens, 1984). In doing this, nature becomes 'a dull affair, soundless, scentless, colourless; merely the hurrying of material, endlessly, meaninglessly' (Whitehead, 1985: 68). Conducting research on structural parameters without considering the intentions that individuals have with these structures and the meaning they give them therefore appears inept (e.g. Weick, 1979). The third point of criticism concerns the relationship between structure and agency. Although it has been argued that structure comprises 'forces that lie outside the control and often the comprehension of place-bound actors' (Kumar, 1995: 188), and that structures are frequently 'irreducible to the activities of contemporary agents' (Reed, 1997: 33), structures also exist only when they are socially reproduced and transformed (Barley, 1986). It seems unrealistic to presume that agents do not influence organizational structures.

¹⁵ Criticism also applies to this methodological standing. Reed (1997), for example, proposes that a process view on structure – or structuring – leaves us with a conception of organization in which properties of structures that 'can be understood to be relatively independent of the agents whose behavior is subject to their influence' (Layder, 1990: 23) are pushed aside by the 'analytical fascination with the local, contingent, and indeterminate' (Reed, 1997). He proceeds by stating that 'flat ontologies and miniaturized local orderings construct a seductive vision of our social world in which everything and everybody is constantly in a 'state of becoming' and never in a 'condition of being' (Reed, 1997: 29). To support his arguments, Reed points at Schumpeter's warning that 'social structures, types, and attitudes are coins that do not readily melt. Once they are formed, they persist, possibly for centuries.' He remarks that this is 'conveniently forgotten in a cacophony of celebrations to the essential flux, fragmentation, and indeterminacy of social reality' (Reed, 1997: 26).

3.3 Case study method

As the diversity of our research questions call for a pluralistic methodological approach, we also utilize alternative forms of investigation, or methods. Some of our research questions require investigation by means of an inductive approach. Or as Klein (2002: 69) puts it, to increase our understanding of contracts and other formalities 'it is [sometimes] necessary to get one's hands dirty and discover how particular contracts actually work in practice.' Case studies are needed because contracts and other acts of formalization 'do not constitute a closed universe' (Brousseau and Glachant, 2002: 23). They are embedded in contexts that influence their functioning. Furthermore, case studies 'allow an investigation to retain the holistic and meaningful components of real-life events – such as [...] organizational and managerial processes' (Yin, 1994: 3). They enable us to get a feeling of which variables are involved, how they could be measured, and how relationships between the variables might be constructed (Eisenhardt, 1989a; Yin, 1994). Case studies are appropriate here, because organizational processes are involved which do not lend themselves easily to quantitative measurements (Strauss and Corbin, 1998), and because history, processes, and context need to be incorporated (Pettigrew, 1990). Adopting the case study approach in research on formalization aligns with Simon's (1997) advice on obtaining insights into the structure and functioning of organizations. He suggests that such insights may be gained by 'analyzing the manner in which the decisions and behavior' of employees are influenced (Simon, 1997: 2). Moreover, the case study method meets critique of existing research concerning the notable paucity of studies penetrating the operational level of interorganizational relationships (Marchington and Vincent, 2004; Parkhe, 1993b). Furthermore, the case study approach connects to the growing attention for post-formation dynamics and developmental processes in interorganizational relationships (Ariño and de la Torre, 1998; Doz, 1996; Doz and Hamel, 1998; Ring and Van de Ven, 1994; Reuer et al., 2002; De Rond, 2003). Finally, it coincides with academic inquiries into the "human" or "process" side of formalization (Marginson and Ogden, 2005) and it enables the development of perspectives on the role of formalization in interorganizational relationships that are 'adequate at the analytical levels of meaning and of causality' (see Ranson et al., 1980: 4)

These reasons have led to the use of the case study method in theme three, which focuses on a so-called how- question (Yin, 1994), namely: "How do managers of interorganizational relationships cope with tensions arising from the co-existence of formalization's functions and dysfunctions?" By using the case study method, we wish to develop a better understanding of the rationales managers have for using a particular degree of formalization, and of the actions that they undertake to cope with the tensions that arise between the positive and negative consequences or functions and dysfunctions associated with formalization. The case study that we discuss concerns a strategic alliance between a large European-based retailer (STEADY) and a global financial services organization (QUICK) aimed at the integration of financial services in a retail context. It is selected for this study as it fulfills three practical and theoretical

conditions. First, both companies offered unique access to their documents and participants in the relationship. Second, both organizations are large in size, something which is often linked to higher levels of formalization (Zeffane, 1989), and which enlarges the likelihood that formalization would be an issue in the alliance. Third, the alliance under study called upon innovative activities from both organizations, while simultaneously high demands for formalization were posed – arising from the legitimacy, accountability, and control characterizing financial services (see Vermeulen, 2001). This setting offered fertile ground for tensions arising from the co-existence of formalization's functions and dysfunctions, which are the topic of theme three.

3.4 Survey method

In other parts of the study, we adopt a more deductive research approach, and we explore survey data on a large number of interorganizational relationships. This method is more appropriate for research questions posed in theme one, four and six, as these lend themselves to quantitative tests on cross-sectional data. In contrast to the case study method, the survey method is used to attain parsimony and external validity (Eisenhardt, 2000). It is a method that is helpful in illuminating the prevalence and incidence of certain phenomena (Yin, 1994). More specifically, surveys are utilized to establish generalizable relationships between formalization, its antecedents, interorganizational performance, moderators, and other governance mechanisms. Investigating these relationships requires large samples of interorganizational cooperative endeavors, as this reduces the risk that findings are the result of highly context-specific or idiosyncratic confounding elements. Where the case study sacrifices breadth for depth (Gill and Butler, 2003), the survey offers some compensation, enabling us to draw more generalizable conclusions.

The data used to answer our research questions in themes one, four and six are obtained from a dataset called The External Management of Automation [MAT95] (Batenburg and Raub, 1995)¹⁶. This dataset captures data on 971 buyer-supplier relationships in which small- and medium-sized buyers have purchased IT-solutions from vendors. The sample includes bilateral contracts; contracts which are 'in some substantial sense incomplete' (Gomes-Casseres, 1996: 35), and which involve promises that possibly have their bearing on the partners during a longer period of time (Ring, 2002), making at least one of the organizations in the relationship dependent on the other (Das and Teng, 2000). Although, at first sight, these relationships might resemble market transactions, they often constitute interorganizational relationships, as they entail maintenance or warranty obligations, delivery of products or services over longer periods, and promises

¹⁶ The data set *The External Management of Automation* has been collected as part of the NWO-pioneer program 'The Management of Matches' (PGS 50-370) and is available from the Steinmetz-Archive (study number P1512). For more details on the data-collection procedure, we refer to Anderson and Dekker (2006), Batenburg (1997), Batenburg et al. (2003), Buskens (2002), Dekker (2003) and Rooks (2002).

regarding product- and service-extensions in future. This means that interorganizational participants, have to interact through a series of stages in which they select their partners, refine specifications of requirements, and deliver goods or services (Bennett and Robson, 2004), acts associated with interorganizational cooperation instead of market-based transactions.

We have selected this type of relationship as our object of analysis, for several reasons. First, buyer-supplier relationships are becoming more important, due to increased competition and a higher pace of innovation, which calls for close cooperation between buyers and suppliers (Noorderhaven et al., 1998). Second, data could be obtained more easily than data on other types of relationships (response rates for surveys under alliance managers, for example, are generally below 10 percent). Third, transactions involving the purchase of IT-solutions offer an appropriate context to test several of the hypotheses that we develop in later chapters, because such relationships generally entail numerous coordination and control problems. Buyers face various risks, stemming among other factors from the difficulty to remain up-to-date with respect to technological developments, and from suppliers that behave opportunistically, painting too rosy a picture of their technology, implementation costs, or operational costs (Rooks, 2002). Moreover, those relationships are characterized by uncertainty and information-asymmetry between buyers and sellers, which complicate the specification of desired outcomes and behavior. In addition, such transactions frequently require relation-specific investments and product customization, which ultimately demand the integration and coordination of actions (Anderson and Dekker, 2006). Finally, buyers in such relationships regularly face low supplier capability, poor supplier performance, loss of control and over-dependence (e.g. Barthelemy, 2001).

The dataset is composed of survey-data from a large stratified sample of IT-transactions by small- and medium sized enterprises, consisting of five to 200 employees. It has been developed by researchers from Utrecht University, in cooperation with the Federation of Dutch IT (FENIT), the Institute of Small- and Medium-Sized Enterprises (IMK), and the Association for Society and Business (SMO) (Batenburg and Raub, 1995). The sample was drawn from a data-file of Directview, a commercial Dutch organization specialized in the marketing of data from the IT-branch. Advantages of this data-file were that: (1) it contained an estimated eighty percent of all Dutch organizations; (2) its data were checked on accuracy and completeness at least once a year; and (3) it captured detailed information on the organization's IT-situation (see Rooks, 2002). The survey developers randomly selected firms until at least 15 cases were identified for each of 36 cells in a stratified research design. The 36 (4x3x3) cells represented unique combinations of three theoretical dimensions: four product groups representing two IT product types, each with two levels of complexity (i.e. software versus hardware, and standard versus complex products), three levels of network embeddedness (i.e. weak, modest, and strong interfirm relations), and three levels of the buyer's expertise (i.e. having one or more full time IT specialists, only part-time IT employees, or no IT-employees) (Anderson and Dekker, 2006). In an additional sampling effort, five industries were selected, namely: (1) food- and

stimulants, (2) basic metal products, (3) means of transport industry, (4) wholesale, and (5) transport- and storage. Respondents consisted of key informants in the buying firm, usually IT managers responsible for the organization's automation. They were first approached in a CATI-interview, to solicit cooperation. When a respondent was willing to cooperate, a transaction was selected that met the stratification criteria. In total 1239 questionnaires were distributed among Dutch small- and medium-sized IT-buyers.

After three reminders, 971 questionnaires were returned by respondents, resulting in a "response rate" – calculated as the number of useful responses divided by the sum of the number of useful, non-useful, and non-responses (see Groves, 1989) – of 78.4 percent. When corrected for the refusals to cooperate during the telephone interview, the cooperation-rate still equaled 58.8 percent (see Rooks, 2002), which is relatively high compared to other research on interorganizational cooperation. The maximum number of transactions with a single supplier (IBM) is thirty and only four suppliers accounted for more than ten transactions each. Approximately 25 percent of the suppliers were part of a larger firm, leaving 75 percent of the suppliers independent firms. Non-response analyses were performed to check for systematic differences between response- and non-response groups. No significant differences were found in the responses per industry and geographical region (Batenburg, 1997). After eliminating responses with too many missing values, 911 observations remained.

3.5 Conclusion

In this chapter, we argued that a comprehensive picture of the role of formalization in interorganizational relationships could only be drawn when different kinds of research questions – as have been developed in chapter one – can be investigated. Methodological pluralism was advanced as a suitable approach for addressing our research questions, as it enables us to juxtapose different theories, based on diverse methodological points of departure. Congruent with this, we use both the case study and the survey method for investigating different parts of our research problem. In the next chapter, we address our first research theme, which considers tensions that may arise between one's needs and abilities to formalize.

4 THEME 1 – NEED VERSUS ABILITY TO FORMALIZE

'The less was the measurability of supplier performance, the wider the use of inter-firm coordination mechanisms'

Delmestri, 1998: 660

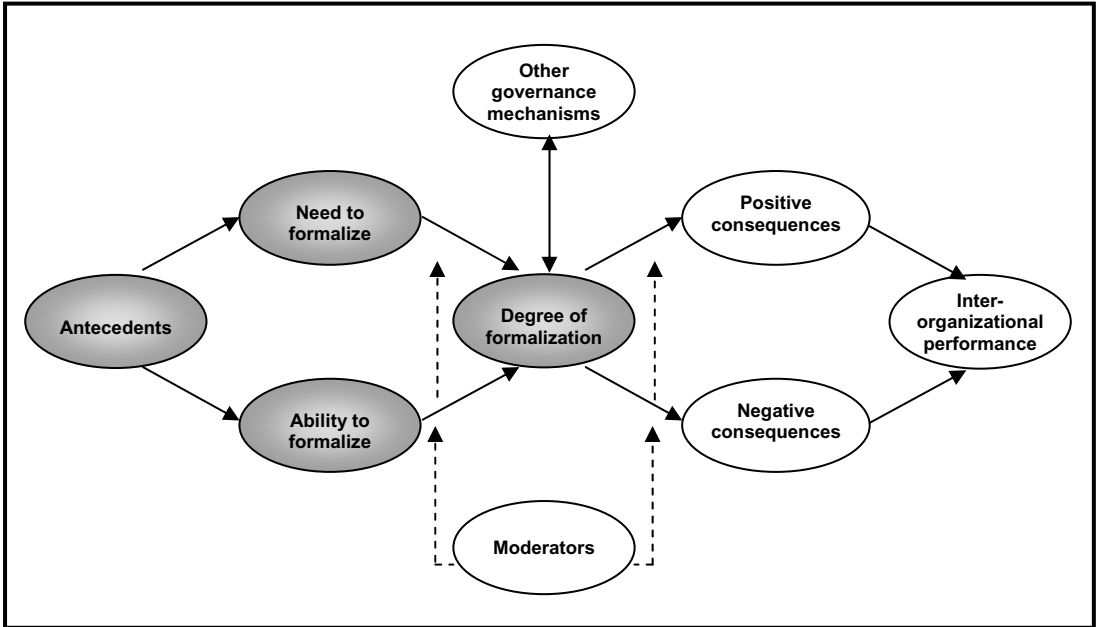
Summary

Research on the antecedents of formalization in interorganizational relationships tends to focus on either their impact on the *need* to formalize, or their influence on the *ability* to formalize. In this chapter, we reconcile both perspectives by proposing that a higher need to formalize is generally accompanied by a lower ability to do so. Managers are expected to cope with this apparent paradox by investing in information processing and sensemaking activities. We empirically test our hypotheses by means of multiple regression analyses on a sample of 911 buyer-supplier relationships. From the results it accrues that higher levels of asset-specificity and complexity, smaller firm sizes, and an absence of prior experience with the same partner produce gaps between the need and ability to formalize, propelling participants in interorganizational relationships to invest in information processing and sensemaking activities. Our inquiry integrates previously separated perspectives on the relationships between formalization and its antecedents. It shows that attempts to establish interorganizational governance mechanisms may induce information processing and sensemaking efforts.

4.1 Introduction

In this chapter, we focus on the shaded parts of the research framework as depicted in Figure 4.1. We observe that research on formalization in interorganizational relationships focuses on either the *need*, or the *ability* to formalize (see Gerwin, 2004; Helm and Kloyer, 2004). It emphasizes either why and when partners are more willing to codify and enforce inputs, outcomes, and processes, or whether and when a partner is in the position to do so. Transaction cost economists, for example, primarily refer to a high need for formal control when considering the effects of investments in relation-specific assets on formalization (Williamson, 1985, 1991). Agency theorists, instead, generally focus on the ability to formalize, which they proxy by the measurability of output and the degree to which behavior can be specified (Eisenhardt, 1989b; Kirsch, 1997; Ouchi, 1979, 1980; Ouchi and Maguire, 1975). Due to the co-existence of these different lines of reasoning, arguments on the relationships between antecedents and formalization tend to point in opposite directions (cf. Vlaar et al., 2005). Being unfamiliar with a potential partner, for example, is argued to demand a high degree of formal controls (e.g. Gulati, 1995), but also to entail a low ability to formalize, due to a lack of knowledge about a partner (e.g. Mayer and Argyres, 2004; Poppo and Zenger, 2002). The resulting tension between the need to formalize and the ability to formalize may explain why researchers have presented inconclusive findings on the relationships between antecedents and formalization (e.g. Blumberg, 2001).

FIGURE 4.1
Research framework – theme one



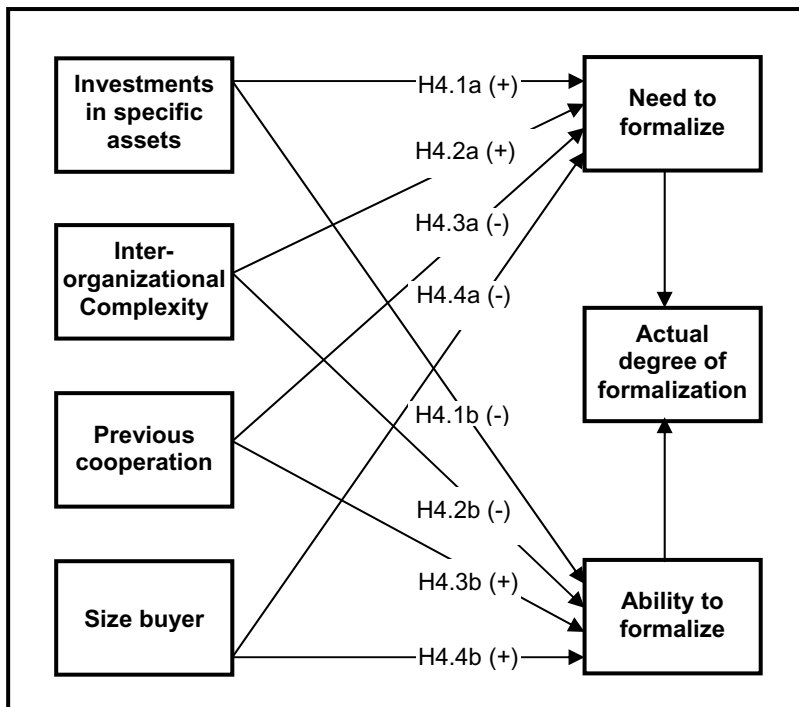
The central problem appears to be that situations that call for higher degrees of formalization are often simultaneously marked by lower abilities to do so (Alchian, 1984; Aulakh and Madhok, 2002). This notion coincides with the idea that ‘contracts may not work when they are needed most’ (Klein Woolthuis et al., 2005: 825), and it resonates with Delmestri’s (1998: 660) finding that ‘the less was the measurability of supplier performance, the wider the use of inter-firm coordination mechanisms’ in 18 organizations in the German and Italian machine-building industry. It leads us to the following research question: to what extent do relationships between antecedents and the ability to formalize diverge from their relationships with the need to formalize? This also elicits the question as to how the ability and the need to formalize eventually influence the degree of formalization in collaborative relationships. We draw on information processing and sensemaking perspectives (e.g. see Daft and Lengel, 1986; Thomas and Trevino, 1993) to propose that gaps between the need and the ability to formalize instigate and propel information processing activities (e.g. acquiring data about products, prices, and terms), as well as sensemaking efforts (e.g. attempts to reduce ambiguity and reconcile perceptions of partners). We test our hypotheses on a sample of 911 buyer-supplier relationships. The results indicate that higher abilities to formalize go hand in hand with lower needs to do so, and vice versa. Increasing information processing and sensemaking activities during negotiations appear to constitute one way to solve this apparent inconsistency.

The chapter contributes to the literature in two ways. First, it integrates previously separate perspectives on the relationships between formalization and its antecedents. It encourages researchers and practitioners to consider both the need and the ability to formalize when investigating and deciding on the degree of formalization that is most appropriate for particular relationships. Second, the research supports calls for extending information-processing arguments 'to broader questions of governance choice' (Carson et al., 2003: 54). It illuminates how tensions between the need and the ability to formalize drive efforts by participants in interorganizational relationships to process information and to make sense of their partners, their relationships, and the collaborative environments in which these are embedded. To accomplish these ends, we organize the chapter as follows. In the theory paragraph, we distinguish four antecedents of formalization, which we derive from transaction cost theory (asset-specificity), literature on behavioral theory and dynamic capabilities (complexity), research on previous cooperation (prior cooperation with the same partner), and the behavioral theory of the firm (size of the buyer). We explain the contradictory influences of each of these variables on the need and the ability to formalize. Subsequently, we advance that investments in information processing and sensemaking are required to enable coordination and control by means of formalization. We then test our hypotheses on a sample of 911 buyer-supplier relationships.

4.2 Determinants of the need and the ability to formalize

Academic contributions on the relationships between antecedents and formalization, in general, have followed two separate lines of reasoning. The first category emphasizes the influence of antecedents on the *need* to formalize. The second category – sometimes starting from the same antecedents – underscores their impact on the *ability* to formalize. The arguments that have been advanced in these contributions frequently point in opposite directions, and it appears that situations calling for higher degrees of formalization are characterized by lower abilities to do so (see Alchian, 1984; Aulakh and Madhok, 2002). Helm and Kloyer (2004: 1110), for example, advance that in some situations 'a contract is needed but, as a result of uncertainty, a complete regulation [...] in the contract is difficult.' A remark of a manager of a chemical company having a relationship with a security firm is illustrative here: 'All what we had written was that we wanted Securiforce to take over our security from January 1999 and that this would be reviewed at the end of the year. This was a new ballgame to us, also. It was a learning process' (Marchington and Vincent, 2004: 1048). It appears that the ability to formalize is typically lower when topics are new and when organizations still have to learn to work together (Mayer and Argyres, 2004). Although the need to formalize might be apparent, bounded rationality, ambiguity and transaction costs may concurrently diminish the ability to formalize (Mukerji, 1998). To assess whether relationships between antecedent variables and the need and the ability to formalize assume contradictory values, we investigate formalization's relationship with four antecedents featuring prominently in the literature. In anticipation of the discussion, Figure 4.2 depicts our hypotheses.

FIGURE 4.2
Antecedents versus the need and the ability to formalize



Investments in relation-specific assets

Investments are relation-specific when they have the highest potential value in the focal relationship; redeployment of these assets outside the relationship diminishes their value or is simply impossible (Dyer and Singh, 1998; Williamson, 1985). A first type of relation-specific investments consists of physical assets, including investments in machinery, information systems, buildings and other physical assets from which little or no value can be recouped outside the relationship (Williamson, 1985, 1991). Another form of asset-specificity concerns human-capital, or even broader, intangible-asset-specificity. Relationship-specific intangible assets can take the form of operating procedures, which are created and refined over multiple cycles of action in the exchange; skills created through specific training, learning by doing, and particularistic experience; and knowledge created in the context of the exchange (Jap and Ganesan, 2000; Subramani and Venkatraman, 2003; Zollo et al., 2002). Such relation-specific investments involve vulnerability, as partners become more dependent on each other. In this respect, Bensaou and Andersen (1999) offer an example of Toyota, which lost a week of production when Aisin, its proportioning valve supplier suffered from a factory fire. No cars could be produced until alternate suppliers were brought up to speed (Nishiguchi and Baudet, 1998), as the specific investments made by Aisin reduced

the range of suppliers that were able to provide valves that were equally suited for Toyota. In general, asset-specificity has therefore been proposed to create room for opportunism, particularly in uncertain environments. Hence, the greater the specificity, the more elaborate the governance mechanisms required to constrain this opportunism (Bensaou and Anderson, 1999: 462; Joskow, 1996: 105). In other words, 'when asset-specificity is high, firms are likely to be more motivated to protect themselves through contractual means' (Gaine and Klaas, 2003: 215). Empirical studies from, among others, Shelanski and Klein (1995), Masten (1996), Palay (1996), and Rindfleisch and Heide (1997) support this line of arguments.

We also contend, however, that high investment in relation-specific assets are associated with a lower ability to formalize. We advance that the knowledge that is linked to such investments, is specific to the relationships concerned as well, and thus more difficult to articulate and codify. Drawing up agreements on rights and obligations related to such investments is harder than for general purpose investments, as it becomes imperative to acquire more knowledge of the partner organizations, and as the investments contain characteristics that are likely to be new to the cooperating organizations. Unlike more "standardized" investments, comparatively little information might be available regarding the characteristics and specificities of this type of investment. These assertions are congruent with Williamson's (1985: 211) remark that '[I]f measurement problems exist, they are assumed to vary directly with asset-specificity.' The latter indicates that investments in relation-specific assets might be of influence on both the need and the ability to formalize. We capture this observation in a first set of hypotheses.

Hypothesis 4.1a: *In the context of interorganizational contracting, the extent to which parties invest in relation-specific assets is positively associated with the need to formalize.*

Hypothesis 4.1b: *In the context of interorganizational contracting, the extent to which parties invest in relation-specific assets is negatively associated with the ability to formalize.*

Interorganizational complexity

Partners in interorganizational relationships may also be confronted with high complexity (Gulati and Singh, 1998). Complexity can relate, among others, to the scope of a relationship (Oxley and Sampson, 2004; Reuer and Zollo, 2005; Sampson, 2004a, 2004b), the number of partners involved (Killing, 1988), and the degree of technological and organizational interdependency between partners (Kumar and Van Dissel, 1996; Thompson, 1967). Researchers have argued that complexity entails a higher potential for opportunistic behavior (Oxley and Sampson, 2004) and that it demands control in the form of rules, scheduling or plans in order to cope with uncertainty and equivocality (Cyert and March, 1963; Moldoveanu and Bauer, 2004; Steensma and Corley, 2000; Thompson, 1967). Others have noticed that higher degrees of complexity demand more coordination (Gulati and Singh, 1998; Heiman and Nickerson, 2004), implying increases in governance costs and administrative overhead (Contractor, 1990; Doz and Hamel,

1998; Williamson, 1985). These arguments are consistent with work from Oxley (1997) and Sampson (2004a), who found that interorganizational relationships move towards more hierarchical governance modes for transactions encompassing a wider range of products, technologies, and partners. In other words, higher degrees of complexity raise the need to formalize.

At the same time, however, complexity is likely to reduce the ability to formalize. Interorganizational relationships that are complex entail complicated mental processes such as problem solving, applying discretion and using technical knowledge (Van de Ven and Delbecq, 1974). This imposes high cognitive demands on the participants in such relationships (Campbell, 1988). Occasionally, the number of variables that have to be considered is so large, and the interconnections among these variables so intricate, that 'common sense and everyday reasoning no longer provide adequate guides' (Simon, 1997: 246). In such cases, the cognitive limitations of human beings preclude the comprehensive representation of complex activity systems by formalities (Simon, 1997). It becomes more difficult and costly to monitor activities and specify issues in contracts or other formal documents, for instance, when more partners are involved with a relationship and when more products or technologies have to be included in a contract (Gulati, 1995; Oxley, 1997). Even if partners know what they want in any possible situation, things may be 'so contingently complex as to resist accurate specification,' or partners may fail in making correct judgments and interpretations (Hendry, 2002: 101). Oxley and Sampson (2004: 725), for example, indicate that 'contractual governance of exchanges involving complex, tacit knowledge is particularly problematic as contracts are very difficult to specify, monitor, and enforce in these circumstances.' Such relationships entail greater uncertainty as to how to evaluate the behavior and performance of partners. Gainey and Klaas (2003: 215) show that parties therefore 'must generally avoid specificity in the development of contracts.' We capture the relationships between complexity and the need and the ability to formalize in a second set of hypotheses.

Hypothesis 4.2a: *In the context of interorganizational contracting, interorganizational complexity is positively associated with the need to formalize.*

Hypothesis 4.2b: *In the context of interorganizational contracting, interorganizational complexity is negatively associated with the ability to formalize.*

Prior cooperation with the same partner

Many interorganizational relationships involve partners that have previously transacted with each other (Kale et al., 2002). Hitherto, however, the literature has remained inconclusive regarding the influence of prior cooperation on formalization, describing two opposing effects. The first effect advanced in the literature consists of a reduced need for formalization (Gulati, 1995; Lui and Ngo, 2004; Saxton, 1997; Zollo et al., 2002). From this perspective, prior relationships can substitute for costly contracts (e.g. Gulati, 1995; Uzzi, 1997). Prior contacts among allying organizations can act as a discipline mechanism that supports cooperation, as it offers prospects of retaliation in future (Ouchi, 1980; Ryall and

Sampson, 2004). Furthermore, prior relationships may have led to the development of trust in a partner organization (Gulati, 1995; Macaulay, 1963; Saxton, 1997). After all, common histories and webs of connections reduce uncertainty (Gulati and Gargiulo, 1999; Larson, 1992), and they assist partners in developing deeper knowledge of each other in terms of their interests, needs and capabilities. The need to set up contracts subsequently diminishes, because parties can make vicarious inferences about likely future behavior of a partner 'by extrapolating a past record into the future' (Parkhe, 1998: 421). Empirical evidence for such an effect of prior cooperation on formalization is found, among others, by Ryall and Sampson (2004), Gulati (1995), Madhok (1995) and Luo (2002).

In contrast, other researchers claim that prior cooperation leads to the proliferation of formalization. As partners come to know more about each other, their ability to formalize increases (e.g. Mayer and Argyres, 2004; Poppo and Zenger, 2002). Recurring interactions lead to a gradual refinement of knowledge of a partner and it increases the 'awareness of the rules, routines, and procedures that each needs to follow' (Gulati et al., 2000: 210). As organizations sustain their business relationships over time, they develop a joint understanding that allows uniquely efficient communication in the form of idiosyncratic interaction routines (Hoang and Rothaermel, 2005; Kotabe et al., 2003; McGinn and Keros, 2002; Zollo et al., 2002). These organizations have developed sets 'of tacit understandings on how to collaborate with each other, how to prevent and remedy misunderstandings, and how to coordinate effectively across organizational boundaries' (Reuer and Zollo, 2005: 106-107). In other words, previous contacts between organizations presumably lead to the development of specialized skills and routines adapted to the partner (Dyer and Singh, 1998; Hoang and Rothaermel, 2005; Kale et al., 2002), and specific knowledge about the partner's structure, operations, and competencies (Shenkar and Zeira, 1992). Prior interactions also lead to improved monitoring and enforcement of contractual compliance and contracting skills (Leiblein, 2003; Mayer and Argyres, 2004; Reuer et al., 2002). When parties are unfamiliar with each other, instead, relationships are reminiscent of low "planability" (Miller et al., 2004). This view on the relationship between prior cooperation and formalization is supported by empirical findings indicating that contracts between familiar organizations are more extensive (Mayer and Argyres, 2004; Poppo and Zenger, 2002; Ryall and Sampson, 2004), and systematically different from those in de novo pairings (Anand and Khanna, 2000b). We capture the presumed links between prior cooperation and the ability and the need to formalize in a third set of hypotheses.

Hypothesis 4.3a: *In the context of interorganizational contracting, prior cooperation with the same partner is negatively associated with the need to formalize.*

Hypothesis 4.3b: *In the context of interorganizational contracting, prior cooperation with the same partner is positively associated with the ability to formalize.*

Size buying organization

On an intra-organizational level, the majority of studies on the relationship between organizational size and formalization indicate that they are positively related (Davila, 2005; Zeffane, 1989). Davila (2005), for example, ascertains that the emergence of management control systems in his sample of 95 young, technology-oriented Silicon-Valley firms is largely driven by firm size. Studies on the influence of organizational size on governance mechanisms in an interorganizational setting are sparse, however, and most of them exhibit non-significant relationships. Reuer and Ariño (2003) and Oxley (1997), for example, find that the size of cooperating organizations has no influence on the use of equity- and non-equity governance forms. Overall, we know little about the relationship between organizational size and the need and ability to formalize. Nonetheless, we expect that interorganizational relationships that involve larger buyers exhibit a lower need to formalize, as they generally possess more slack resources, which could help them to overcome problems resulting from the application of insufficient safeguards (March and Simon, 1958). Besides, large buyer organizations are likely to engender higher volumes of future activities, making them more attractive to suppliers, and reducing their susceptibility to opportunistic behavior by suppliers. After all, suppliers' expectations of repeated business with buyer organizations can act as a discipline mechanism supporting cooperation (Ryall and Sampson, 2004), and prospects of retaliation in future periods may curb non-cooperative behavior in current periods (Ryall and Sampson, 2004b; Williamson, 1985). Findings from Palay (1996) on governance choices in 51 transactions between rail freight carriers and their shippers support this assertion. Palay ascertains that for 19 transactions opportunistic conduct was attenuated by parties' apparent reluctance to exploit short-term advantages to the detriment of long-run relations.

Conversely, we claim that the ability to formalize is higher for large organizations compared to small organizations. Large organizations possess more resources that they can dedicate to the formalization of their relationships (March and Simon, 1958). They are also more likely to have exhaustive legal expertise at their disposal. Moreover, these organizations are probably able to draw from more prior experience concerning negotiations and contracting practices in interorganizational relationships, which enhances their ability to identify and recognize issues and opportunities, and which promulgates their ability to capture these in formal documents. In other words, these organizations are more likely to possess contracting capabilities (Mayer and Argyres, 2004). Furthermore, many large organizations possess alliance departments and formal procedures for establishing and maintaining relationships (Bagley et al., 2005; Kale et al., 2002), which enhances their ability to formalize. The connections between size of the buyer organization and the need and ability to formalize that we advance here are captured in a fourth set of hypotheses.

Hypothesis 4.4a: *In the context of interorganizational contracting, the size of a buyer is negatively associated with the need to formalize.*

Hypothesis 4.4b: *In the context of interorganizational contracting, the size of a buyer is positively associated with the ability to formalize.*

4.3 Information processing and sensemaking

Our review of the literature suggests that the ability and the need to formalize are influenced by the same antecedents, although in opposite directions. Ironically, the very characteristics that propel the need for formalization thus also appear to complicate doing so (see Alchian, 1984; Chi, 1994). These factors challenge clear definition and verification, complicate assessments of potential complementarity, and raise the extent of ambiguity in specification and measurement (Madhok and Tallman, 1998). Unless partners undertake strenuous efforts to enhance the ability to formalize, formalization will therefore either assume low values or prove to be ineffective, as key decision makers have no solid understanding of the relationship, lack a common fact base and are unclear about important assumptions (see Kaplan and Beinhocker, 2003). Exact stipulations in formal documents then need to be postponed until the moment when uncertainty and equivocality have decreased sufficiently (Helm and Kloyer, 2004). Interorganizational participants do not wait for this to happen, as coordination and control are purposeful, goal-oriented activities (Makhija and Ganesh, 1997). Instead, they will seek to ameliorate the quality of the information upon which they base their decisions (Simon, 1997). Analogue to Thomas and Trevino (1993), we therefore presume that they undertake efforts directed at information processing (e.g. Galbraith, 1973, 1977; Tushman and Nadler, 1978), and sensemaking (e.g. Weick, 1979, 1995, 2001) to reduce uncertainty and equivocality, and consequently to improve the ability to formalize (see also Daft and Lengel, 1986; Pfeffer and Salancik, 1978; Ring, 1997)

Information processing refers to the acquiring, interpreting and synthesizing of information (Huber, 1991; Tushman and Nadler, 1978). Organizations are reputed to process information in order to reduce uncertainty (Daft and Lengel, 1986; Galbraith, 1973; Tushman and Nadler, 1978), and to enable coordination and control (Galbraith, 1977). Information processing is believed to ameliorate expectations about the future value of resources to an organization (Makadok and Barney, 2001) and to augment the controllability of issues and situations (Kuvaas, 2002; Thomas et al., 1993). Daft and Lengel (1986: 555), for example, suggest that 'managers try to find decision rules, information sources, and structural designs that afford adequate understanding to cope with uncertainty,' which is an assertion that can be logically extended to the interorganizational level of analysis (Bensaou and Venkatraman, 1995). Managers experiencing the need to engage in more vigilant and deeper examinations of a situation at hand search for information (Thomas and McDaniel, 1990; Tushman and Nadler, 1978). By acquiring and processing information, they reduce uncertainty (Daft and Lengel, 1986; Galbraith, 1977), which enables higher levels of formalization.

However, managers are not only concerned with deficiencies of information, but also with a lack of clarity and with the existence of equivocality (Carson et al.,

2006; Daft and Lengel, 1986; Daft and Weick, 1984). The latter implies that multiple and conflicting views exist about an issue (Weick, 1979), something which cannot be solved by gathering more information. Differences in interpretation of information and divergent meanings attached to cues, for instance, can result in participants holding conflicting values and developing distinct perspectives on interorganizational issues (Gray, 1985). For consensus and action to occur, interpretations of the information held by cooperating parties must be synthesized and meaning must be communicated (Thomas and Trevino, 1993). Partners consequently attempt to remove equivocality from relationships by investing in sensemaking activities. These activities are reputed to reduce suspicion about the partners' motives and to remove confusion regarding the partners' responsibilities (Gray, 1985; Thomas and Trevino, 1993). Sensemaking involves the reciprocal interaction between information seeking, meaning ascription, and action (Gioia and Chittipeddi, 1991; Weick, 1979). Efforts directed at sensemaking include, among others, asking questions, probing, active detection of information (Daft and Weick, 1984), discussion and debate (Daft and Lengel, 1986), and cross-checking ones own perceptions and interpretations with those of participants from the other organization. Sensemaking efforts also pertain to the information processing efforts previously discussed, as managers who have larger amounts of information available are presumed to have more raw materials for constructing their interpretations (Daft and Weick, 1984; Kuvaas, 2002). This enables them to develop more accurate perceptions, and to imbue data and information with meaning (Thomas et al., 1993). Sensemaking efforts are particularly manifest during the negotiations preceding transactions. The social-psychological processes of sensemaking that lie behind the formal bargaining processes characterizing negotiations help participants to appreciate the potential for transacting with others and they assist in clarifying the nature of interorganizational relationships (Ariño and Ring, 2004; Ring and Van de Ven, 1989). We propose that strenuous information processing and sensemaking efforts are elicited in order to enhance interorganizational performance in cases in which a low ability to formalize is accompanied by a high need to formalize. In these situations, partners gather data and they attempt to reduce ambiguity before they enter formal commitments in order to reduce the gap between the information required and the information available (Tushman and Nadler, 1978), and to enhance participants' understanding of their situation. After all, 'commitments and formalized arrangements are not developed prematurely, when sensemaking and understanding processes are still producing unclear products and the parties are ambivalent as to the benefits of a transaction for themselves or their organizations' (Ring and van de Ven, 1989: 183). This leads us to the following hypotheses.

Hypothesis 4.5: *In the context of interorganizational contracting, the size of the gap between the ability and the need to formalize is positively associated with the efforts that are invested in information processing and sensemaking.*

Hypothesis 4.6: *In the context of interorganizational contracting, efforts invested in information processing and sensemaking are positively associated with the degree of formalization.*

4.4 Method

Consistent with Poppo and Zenger (2002), we measure *relation-specific investments* by three indicators reflecting the costs related to switching to another supplier. Questionnaire items for this variable are concerned with the damage in terms of time and money that the buyer would face if the product had to be replaced due to malfunctioning. The individual items refer to the need to 'purchase a new product,' 're-educate personnel,' and 're-enter data.' Jointly, these indicators provide an indication of the magnitude of the buyer's hold-up problem (see Dekker, 2003). Cronbach's α for this scale amounts to 0.75. *Complexity* is measured by two indicators (see Dekker, 2003). First, we develop a count-measure of the number of products involved in a transaction. Many transactions do not comprise the purchase of one, but of multiple products. Eighteen product categories are distinguished, including: standard software; network-configurations; design; adapted software; mini-computers; training; tailor-made software; mainframes; instruction; branch-specific software; computer-directed machines; advise; personal computers; peripheral equipment; documentation; work-stations; cables; and, support. When products in one of these product categories are involved in a transaction, they obtain a score of one. The number of products is then calculated as the sum of the values for each product category. In order to obtain a normal distribution, we take the square root of this value. The second indicator results from subdividing the 18 product types into different product categories, each entailing disparate degrees of complexity. The product types are divided over five categories (1= most simple product categories, 5= most complex product categories). The lowest value for the scale consists of standard products, which include standard software packages, personal computers, workstations, and peripheral equipment, such as cables and accompanying devices. The highest level of complexity consists of tailor-made software and specific design activities. A Guttman-type scale is then developed in which the level of complexity is determined by taking the maximum complexity levels present in a transaction. Finally, overall complexity of a transaction is measured by both the number of products transacted and the complexity-level involved with the transaction. Cronbach's α for this measure is 0.71, which is slightly above the guideline of 0.7 for modest composite reliability (Nunnally, 1978). Consistent with previous research (e.g. Dekker, 2003; Kale et al., 2000; Oxley and Sampson, 2004), we measure the existence of *prior relationships* between the same partners by a dummy variable, indicating whether the buyer and the supplier had undertaken business with each other before or not (0= no prior relationship, 1= prior relationship). We recognize that this is a very crude indicator, but believe it suffices for our purpose, which is to assess whether prior cooperation influences the ability and the need to formalize in opposite directions. Furthermore, following previous research (Heiman and Nickerson, 2004; Muthusamy and White, 2005), we measure *size of the buyer* by two indicators. The first indicator consists of the number of employees of the buyer organization before the transaction. As this measure is highly skewed, the logarithm of these values is taken (see Davila, 2005). The second indicator consists of the turnover of the buyer before the transaction (see Heide, 2003). As the distributions of this item is highly skewed,

the logarithm is taken of these values. Cronbach's α for the scale containing both items equals 0.73. We measure *the ability to formalize* in terms of three items. At the first item, the respondent had to indicate 'how difficult it was for his or her organization to compare this product with similar products.' The second item referred to 'how difficult it was for his or her organization to compare the price-quality ratio of potential suppliers' The third item indicated whether 'it was difficult or hard for employees to evaluate the quality of this product at the time of delivery' Responses follow a 5-point Likert-scale (1= 'very easy,' 5= 'very difficult'). As the ability to formalize is a construct with a positive orientation, the scales were reverse-coded. Cronbach's α for this scale was equal to 0.79. The construct validity of this measure is checked by analyzing its correlation with a measure for the relative experience of the focal organization with automation compared to other organizations in the same industry. Pearsons' correlation statistic for the correlation between both variables is equal to .30 ($p < .00$), indicating that organizations that are relatively more experienced with automation possess a higher ability to formalize, something which strongly reinforces our belief that our measure for the ability to formalize is appropriate. *The need to formalize* is not measured explicitly. Instead, we measure the actual degree of formalization. In case the four antecedents that we investigate exhibit opposite relationships with the actual degree of formalization and the ability to formalize, we claim that their effects on the need and ability to formalize differ. If a higher level of complexity leads to a lower ability to formalize, but also to a higher degree of formalization, for example, we infer that complexity must have a positive influence on the need to formalize. Hence, we use *the degree of formalization* as a proxy for the need to formalize. We construct this measure from the respondent's answers regarding the presence or absence of 24 contract clauses, including ones on: price determination; liability of the supplier; restrictions on product use; price-levels; force majeure; nondisclosure by the buyer; up-dating; arbitration arrangements; settlement of R&D costs; joint management; technical specifications; termination periods; price changes; warranties; insurance by the supplier; payment terms; quality (norms); service periods; sanctions for late payment; intellectual property rights; the reservation of spare parts; delivery times; protection of the product; and, maintenance periods. Individual contract terms receive a value of one when the respondents indicated that they were included as a clause in the contract, whereas they are coded zero when the subject was not arranged or only arranged verbally. Subsequently, the degree of formalization is calculated as a count measure of the contractual agreements on the 24 financial, legal, and operational issues that were actually covered by the contract. We measure *information processing and sensemaking activities* as the number of days the respondent and his/her colleagues jointly spent on drawing up the contract and negotiating with the supplier. This conforms with previous research, in which measures of data search have been proposed as proxies for 'mindful' versus 'mindless' cognitive processing (e.g. Dunegan, 1993). To obtain a positive normal distribution, we take the log of this measure and add a value of one to all observations. We further include size of the supplier and *financial volume of a transaction* as control variables. *Size of the supplier* might influence the need to contract, as larger suppliers possess more bargaining power, and as the relative degree of

dependence of the buyer on the supplier is likely to become larger. Consistent with previous research (Heiman and Nickerson, 2004; Muthusamy and White, 2005), this variable is measured by one indicator consisting of the number of employees at the supplier before the transaction. The response categories are divided into five value ranges (1= less than 5; 2 = 5-9; 3 = 10-19; 4 = 20-49; and, 5 = more than 50). With respect to *financial volume*, transaction cost economists suggest that organizations deal more cautiously with transactions involving greater investment commitment (Chi, 1994; Williamson, 1985), as they generally involve higher dependency of an organization on its transaction partner and higher risks (Heide and John, 1988). Financial volume is therefore proposed to be positively associated with the degree of formalization (Batenburg et al., 2003; Blumberg, 2001; Yan and Gray, 2001). It is measured as the volume of payments from the buyer to the supplier organization (see Heide, 2003), excluding payments for extra work (response categories: 1= <€ 11.363, 2= € 11.363 to € 22.726, 3= € 22.726 to € 45.455, 4= € 45.455 to € 90.909, and 5= more than € 90.909).

4.5 Results

To test our hypotheses, we first calculate correlation statistics (see Table 4.1), which are consistent with earlier research on the same data (Batenburg et al., 2003; Buskens, 2002). Pearson's correlation coefficient between the ability to formalize and the actual degree of formalization reveals a significant negative relationship ($b = -.220$; $p < .01$), providing a first indication that the need and the ability to formalize move in opposite directions. To obtain stronger support, we regress each of the antecedent variables on the ability to formalize and on the actual degree of formalization.

TABLE 4.1
Correlation matrix

	Mean	SD	1	2	3	4 ¹	5	6	7	8	9
Asset-specificity	8.66	3.04	1.00								
Complexity	5.32	2.02	.40	1.00							
Prior cooperation ¹	.500	.500	-.15	-.09	1.00						
Size buyer	5.79	.87	.05	.09	.00	1.00					
Size supplier	3.40	1.47	.17	.13	.09	.27	1.00				
Financial volume	2.54	1.46	.37	.43	-.06	.42	.38	1.00			
Formalization	9.40	2.67	-.39	-.30	.17	.01	.07	-.28	1.00		
Ability to formalize	10.7	5.84	.32	.35	-.13	.11	.35	.42	-.22	1.00	
Info & sensemaking	1.23	.53	.37	.37	-.11	.23	.20	.54	-.31	.39	1.00

¹ Correlations with prior cooperation consist of Kendall's tau-b. Correlations higher than 0.07 are significant at the 0.05-level and correlations higher than 0.10 are significant at the 0.01-level.

Table 4.2 displays the results. The findings confirm hypotheses 4.1 to 4.4. Where asset-specificity and complexity reduce the ability to formalize, they raise the degree of formalization, which we believe derives from a higher perceived need to formalize. Moreover, relationships between partners that have previously cooperated and relationships involving larger buyers entail a higher ability to formalize than relationships between unfamiliar partners, or relationships involving small buyers. However, the same factors are also associated with lower degrees of formalization, indicating lower needs to formalize in these relationships.

To test for hypothesis 4.5, we regress “information processing and sensemaking” on the four antecedent variables. The results of this analysis are presented in the final column of Table 4.2. Asset-specificity and complexity augment information processing and sensemaking efforts. This is congruent with Tushman and Nadler’s (1978) assertion that complexity or interdependence between organizational units raises information processing requirements. Prior experience with a partner, instead, reduces information processing and sensemaking efforts. The latter corroborates Ring’s (1997: 296) remark that, in cases where cooperative relationships involve partners with prior ties, it seems probable that ‘actors will not need to rely heavily on sensemaking or understanding processes’ (Ring, 1997: 296). Interorganizational relationships among parties who have previously cooperated can therefore ‘be expected to evolve more rapidly than when reciprocal sensemaking, understanding or committing processes have not been employed repeatedly between them in the past’ (Ring, 1997: 296).

TABLE 4.2
Multiple regression analysis: Antecedents of the need to formalize, the ability to formalize, and information processing and sensemaking efforts

	Need to formalize		Ability to formalize		Info processing & sensemaking	
	B	Sig.	B	Sig.	B	Sig.
Constant	4.400	***	7.055	***	-.636	***
Asset-specificity	.106	**	-.267	***	.152	***
Complexity	.168	***	-.123	***	.116	***
Prior experience	-.118	***	.120	***	-.065	**
Size buyer	-.081	**	.095	**	.035	
Size supplier	.251	***	.018		.000	
Financial volume	.237	***	-.163	***	.416	***
N	569		569		550	
F-value	38.002	.000	24.962	.000	46.852	.000
R ² – adjusted	.281		.202		.333	

Correlations significant at the 0.05-level (**), and the 0.01-level (***)

Size of the buyer does not appear to influence buyers' information processing and sensemaking efforts. This suggests that although smaller firms experience a higher need to formalize, and a lower ability to do so compared to larger firms, they do not put more efforts into information processing and sensemaking to reduce uncertainty and equivocality and to enable formalization. This might be due to the limited number of resources that these firms have available.

To test for hypothesis 4.6, we investigate whether information processing and sensemaking efforts can explain part of the formalization efforts undertaken in the relationships that we study. In Table 4.3, we compare a baseline regression on formalization (model 1) with a model incorporating information processing and sensemaking as an explanatory variable (model 2). Adding information processing and sensemaking efforts as an explanatory variable accounts for an additional 1.7 percent of the variance compared to the baseline model. The variable assumes a highly significant value ($b = .170$; $p < .01$). We conclude that information processing and sensemaking efforts explain a significant amount of variance in the degree of formalization applied in interorganizational relationships

TABLE 4.3
Influence of information processing and sensemaking on formalization

	MODEL 1		MODEL 2	
	B	Sig.	B	Sig.
Constant	4.400	***	3.723	**
Asset-specificity	.106	**	.080	*
Complexity	.168	***	.148	***
Prior experience	-.118	***	-.107	***
Size buyer	-.081	**	-.087	**
Size supplier	.251	***	.251	***
Financial volume	.237	***	.166	***
Info & Sensemaking			.170	***
N	569		550	
F-value	38.002	.000	34.411	.000
R ² - adjusted	.281		.298	
R ² - change			.017	

Correlations significant at the 0.10-level (*), the 0.05-level (**), and the 0.01-level (***)

4.6 Discussion

In this theme, we investigated how contradictory findings on the relationships between antecedents and formalization that prevail in the literature can be reconciled. We argued that similarly to partner selection (Ahuja, 2000) and learning (Inkpen, 2000), interorganizational governance efforts depend on parties' *needs* and their *abilities* to coordinate and control their relationships. We capitalized on the observation that the arguments underlying empirically established relationships between antecedents and formalization tend to centre *either* on the need, *or* on the ability to formalize, *but not on both* (see Gerwin, 2004; Kirsch, 1997). This evoked the question as to whether antecedents accommodate contradictory forces. In addition, we were interested in how the ability and the need to formalize eventually determine the degree of formalization in interorganizational relationships, which led to the following research questions.

RQ1: To what extent do relationships between antecedents and the *ability* to formalize diverge from their relationships with the *need* to formalize?

RQ2: How do the ability and the need to formalize influence the degree of formalization in interorganizational relationships?

Key findings

We proposed that a high need to formalize activities and outcomes tends to co-exist with a low ability to do so. In particular, we expected this to be the case for interorganizational relationships involving significant investments in relation-specific assets, high degrees of interorganizational complexity, an absence of prior cooperation, and small focal organizations. Subsequently, we advanced arguments from information processing theorists (e.g. Galbraith, 1973, 1977), and from authors on sensemaking (Weick, 1979, 1995, 2001) to explain how participants in interorganizational relationships resolve the resulting impasse. We proposed that information processing and sensemaking efforts would be higher in relationships in which the ability and the need to formalize diverge more strongly compared to other relationships. The results corroborated our hypotheses. Collectively, they underscore the idea that antecedents that are commonly associated with formalization in the literature give rise to multiple, contradictory forces, and that tensions between these forces induce participants in interorganizational relationships to invest in information processing and sensemaking.

Theoretical and practical implications

Our findings have numerous ramifications for researchers and practitioners. On a theoretical level, they indicate that contradictory relationships between antecedents and formalization may co-exist. We therefore recommend researchers to take into account the *ability* as well as the *need* to formalize in future research. Moreover, as we found that partners may overcome discrepancies between the ability and the need to formalize by investing in information processing and sensemaking efforts, researchers should take

managers' tendencies to surmount difficulties to formalize into account when investigating the role of formalization in interorganizational relationships. Moreover, our findings imply that perversely, the alliances that are particularly useful are also especially difficult to manage (Accenture, 2003). Hence, it might sometimes be better for practitioners to pursue less complex cooperative ventures, or to design their ventures in a modular way – with a small interface between the cooperating organizations – so that participants in interorganizational relationships are better able to handle the complexity involved with interorganizational cooperation. Of course, this does not mean that they should just initiate external relationships that are easy to govern. Relationships between familiar partners, for example, might render cooperation easier, but their performance benefits are frequently overstated, making careful assessments of alternative partners advisable (Hoang and Rothaermel, 2005). Furthermore, managers should be aware of the fact that investments in information processing and sensemaking may facilitate formalization of more sophisticated relationships. Without these investments, formalization may become an inadequate means to achieve coordination and control.

Limitations and opportunities for future research

Our research has several limitations, which could be addressed in future research. First, we conformed to a widely held tenet in the literature, by paying only limited attention to the role of managers in the process of structuring interorganizational relationships (Pfeffer and Salancik, 1978). Our focus lay on the task characteristics and elements of the external environment that influenced organizational structuring activities. Previously, however, it has been remarked that such relationships can only be acted upon if participants are able to sense and interpret the environment and respond to it (Daft and Weick, 1984; Ring and Van de Ven, 1994). To obtain better insights into the origins and evolution of interorganizational governance (Cardinal et al., 2004; Narayandas and Rangan, 2004), future research could therefore consider *how and on what basis* managers decide to apply particular degrees of formalization (see also themes two and three). Second, we did not empirically disentangle information processing from sensemaking efforts, although Jemison and Sitkin (1986) and Thomas and Trevino (1993) already explained that an overemphasis on either information processing or sensemaking could inhibit interorganizational performance. This suggests that investigations of the interplay between both activities might be worthwhile. Another avenue for future research could be to replicate this study with a sample of interorganizational relationships in which the ability and the need to formalize might diverge even more. We expect, for instance, that strategic alliances and outsourcing relationships entail more intensive cooperation between partners compared to buyer-supplier relations. After all, these relationships 'bring together multiple parties from different organizations with differing goals, cultures, and interpretations' (Thomas and Trevino, 1993: 782). In such relationships, it might be even more critical to reduce uncertainty and equivocality, and the effects that we have found may become even more pronounced.

5 THEME 2 – FUNCTIONS OF FORMALIZATION

‘...the focus in much of organizational theorizing is to homogenize what is essentially a pluralistic world. On balance, organizational theorists have tended to emphasize the unifying principles that lend cohesion, focus, legitimacy, and identity; the result has been to problematize (or often overlook) the variety embedded in pluralism.’

Glynn, Barr and Dacin, 2000: 726

‘The formal process of negotiating enables, perhaps even forces, the parties to engage in sensemaking.’

Ring and Van de Ven, 1989: 185

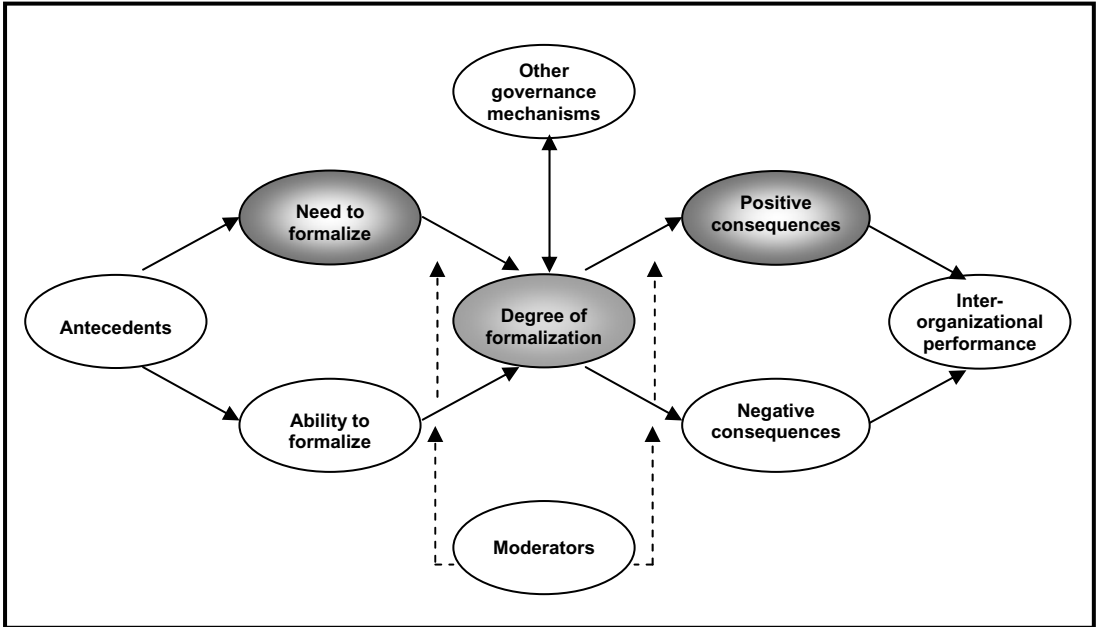
Summary

Research on interorganizational governance focuses primarily on problems of coordination, control, and to a lesser extent legitimacy. We develop a complementary perspective, proposing that formalization enables interorganizational participants to give and make sense of the relationships in which they are engaged. Our work is grounded in the governance and sensemaking literatures. It illuminates relationships between sensemaking and other functions of formalization, and it complements existing perspectives concerning formalization’s relationship with interorganizational performance and its conduciveness to particular contexts and cooperative stages. Furthermore, by illuminating multiple theoretical perspectives on formalization, we attempt to ‘provide more creative, innovative, and insightful ideas, facilitating new theory generation and enhancing the level of disciplinary maturity’ (Robson et al., 2002: 392) in the interorganizational governance field. The chapter thereby answers calls from, among others, Glynn et al. (2000) for advantaging pluralism and paradigmatic eclecticism more explicitly in organizational theorizing.

5.1 Introduction

A large variety of functions has been ascribed to formalization, of which Randolph Marcy (1859), a U.S. army captain who has written *The prairie traveler: A handbook for overland expeditions* stipulates some examples (Bamford et al., 2003). Marcy argued that formalization promoted collaboration between colonists and other prairie travelers when they were travelling from the East to the West of the United States during the 19th century (see Textbox 5.1). However, the functions of formalization appear to be more diverse than those surfacing in his story. In this chapter, we focus on the functions of formalization, which are closely associated with the need to formalize and the positive consequences of formalization, forming the shaded areas in the research framework depicted in Figure 5.1. The functions ascribed to formalization that are most prevalent in the literature are grouped into three broad categories: (1) formalization as a means to *coordinate*, (2) formalization as a means to *control*, and to a lesser extent (3) formalization as a means to *legitimize* (e.g. Dyer, 1997; Gulati and Singh, 1998; Salbu, 1997; Sobrero and Schrader, 1998; Madhok, 2002; Kale et al., 2001).

FIGURE 5.1
Research framework – theme two



In contrast to these now widely accepted perspectives on the functioning of formalization, this chapter focuses on its sensegiving and sensemaking function, which derives its theoretical underpinnings from Weick's (1969, 1979, 1993, 1995, 2001) theory of sensemaking and from emerging cognitive theories of organization and governance (e.g. Lindenberg, 2003; Meindl et al., 1996). We start by noting that although 'formal organizations are generally understood to be systems of coordinated and controlled activities' (Meyer and Rowan, 1977: 340), for which information processing is crucial, they are increasingly regarded as systems of meaning (Meindl et al., 1996). This implies that research on interorganizational relationships not only focuses on interest- and information-asymmetry problems anymore, but that it also considers issues relating to "the meeting of minds", sensemaking, and the ways in which participants in interorganizational relationships reduce ambiguity and equivocality (e.g. see Carson et al., 2006). Sensemaking is central here, because 'it is the primary site where meanings materialize that inform and constrain' action (Weick et al., 2005: 409, citing Mills, 2003: 35). Concordant with the significance attributed to sensemaking, and with Weick's pleas for more research on processes instead of structures, increasing attention is granted to process dynamics and the evolution of interorganizational cooperative endeavors (e.g. De Rond, 2003; De Rond and Bouchikhi, 2004; Doz, 1996; Narayandas and Rangan, 2004; Reuer et al., 2002; Ring and Van de Ven, 1989, 1994).

TEXTBOX 5.1

Formalization among prairie travellers

'An obligation should be drawn up and signed by all the members of the association, wherein each one should bind himself to abide in all cases by the orders and decisions of the captain, and to aid him by every means in his power in the execution of his duties; and they should also obligate themselves to aid each other, so as to make the individual interest of each member the common concern of the whole company' (Marcy, 1859: 23). 'In case of failure on the part of any one to comply with the obligations imposed by the articles of agreement after they have been duly executed, the company should of course have the power to punish the delinquent member, and, if necessary, to exclude him from all the benefits of the association' (Marcy, 1859: 24). Unless a systematic organization be adopted it is impossible for a party of any magnitude to travel in company for any great length of time, and for all the members to agree upon the same arrangements in marching, camping, etc. I have several times observed, where this has been attempted, that discords and dissensions sooner or later arose which invariably resulted in breaking up and separating the company' (Marcy, 1859: 25).

Besides, prairie travelers needed plans and budgets to know not just the requisite food to bring, but also the amount of water, clothing, bedding, and, of course, arms. Travellers needed a clear resource budget – from 150 pounds of flour all the way down to four pairs of socks and a bit of beeswax, as overloading was a real danger. Poor up-front planning left many pioneers dead on the prairie – starved, frozen, or, more likely, unable to recover from minor sickness or injury. It also made them face exorbitant prices at outposts such as Ford Dodge or Council Grove (Bamford et al., 2003: 315). Other formalities that are required when traversing the prairies with a group of people include agreements on telegraphic signals, and smoke signals (Marcy, 1859: 227-228). Marcy notes that these signals, when well understood and enforced, tend to greatly facilitate the communication of intelligence throughout the camp, and contribute much to its security. To avoid mistakes, the signals should be written down and copies furnished the commander of each party.

Source: Bamford et al. (2003) and Marcy (1859)

Following Carson et al. (2006), we believe that shifting the focus of attention from formalities, such as contracts, rules and procedures, towards the process of formalization could complement our existing understanding of formalization's functioning in interorganizational relationships. In particular, by focusing on formalization as a process, we can come to better understand the dynamic creation of shared understandings that underlie the logic of exchange (Ariño and Ring, 2004; McGinn and Keros, 2002). These considerations raise the following questions: what are the functions of formalization? How do these functions relate to each other? What is their relationship with interorganizational performance? And, finally, what is their relative importance in different collaborative contexts and stages of interorganizational development? By critically examining previous research on formalization's consequences and by building upon Karl Weick's work on sensemaking, and Ring and Van de Ven's (1989, 1994) work on interorganizational structuring practices, this chapter discerns a function of formalization, which has received little attention in the literature so far:

formalization as a means to give and make sense. It thereby contributes to the literature in two ways. First, it extends Weick's concept of sensemaking into a new domain, complementing existing views on interorganizational governance. The diversity of arguments underlying the sensegiving and sensemaking function of formalization demonstrates that researchers on interorganizational governance could benefit from more explicitly considering sensemaking in their studies. Second, by presenting an integrative framework that embraces conceptualizations of formalization as a means to coordinate, control, legitimize and give and make sense, we cross the boundaries of narrow theoretical domains (Baum and Rowley, 2002). We thereby help to reconcile seemingly contradictory perspectives on interorganizational governance, and show that a more holistic perspective on the functioning of contracts, rules and procedures, and the processes from which they arise, offers a richer and more appropriate description of interorganizational governance than hitherto available.

We organize the chapter as follows. First, we categorize the prevailing modes of thinking on the functioning of formalization in interorganizational relationships by distinguishing between its coordination, control, and legitimacy effects. We contrast these perspectives with a conceptualization of formalization as a means to give and make sense. Subsequently, we illustrate how formalization contributes to sensegiving and sensemaking by elaborating on its role in focusing attention, reducing ambiguity, and facilitating articulation, deliberation, interaction, and learning. In addition, we advance that formalization contributes to a reduction in judgment errors, and to more complete and consistent images of interorganizational reality. We proceed by suggesting how formalization's sensegiving and sensemaking function relates to its more traditional coordination, control and legitimacy functions, and we clarify how it is associated with interorganizational performance. Finally, we explain how the relationships between formalization's four functions and interorganizational performance are moderated by the exploration and exploitation character of collaborative contexts, and stages of development of interorganizational relationships.

5.2 Four perspectives on formalization

Table 5.1 provides an overview of the major characteristics of the coordination, control and legitimacy perspectives on the role of formalization in interorganizational relationships. It also encompasses the main features of a sensegiving and sensemaking perspective on formalization, which is central to this chapter. The ubiquity of research on the coordination, control and legitimacy functions of formalization stems from a historical preponderance of theoretical perspectives in which rationality, computation, anticipation and decision-making have prevailed. It is embedded in a rich tradition of cross-sectional governance research (see Barley, 1986) and seems to be the result of a manner of thinking in which the costs of formalization are justified only by its outputs and 'not by the learning benefits of the codification process itself' (Zollo and Winter, 2002: 349).

TABLE 5.1
Overview of different perspectives on formal interorganizational governance

	Coordination perspective	Control perspective	Legitimacy perspective	Sensegiving & sensemaking perspective
Foundations	March and Simon's theory of organizational behavior & Dynamic capabilities school	Transaction cost theory & Agency theory	Institutional theory	Weick's theory of sense-making & emerging cognitive views on organizations and governance activities.
Deviation from neoclassical theory	Analytical focus on "friction in production"	Analytical focus on "friction in exchange"	Analytical focus on "friction in comfort with external initiatives"	Analytical focus on "friction in understanding/cognition"
Key assumptions	Partners are boundedly rational and therefore experience difficulties in combining complementary resources. Efficient execution of interorganizational activities requires an appropriate division of labor between partner organizations and up-front investments.	Partners are boundedly rational and therefore cannot foresee all future contingencies. Partners are self-interest seeking with guile. They possibly behave opportunistically.	Stakeholders are boundedly rational and therefore evaluate interorganizational activities based on a limited number of structuring mechanisms that conform to generally accepted principles. Participants in interorganizational relationships attribute meaning to interorganizational activities and collaborative contexts.	Partners are confronted with ambiguity and equivocality arising from differences in nationality, history, resources, et cetera. Participants in interorganizational relationships attribute meaning to interorganizational activities and collaborative contexts.

TABLE 5.1
Overview of different perspectives on formal interorganizational governance (continued)

	Coordination perspective	Control perspective	Legitimacy perspective	Sensegiving & sensemaking perspective
Major arguments	Organizations formalize their interorganizational activities to coordinate activities with a partner organization and to make sure that they jointly "create a larger pie"	Organizations formalize their interorganizational activities to control their partner, and to make sure that they can "appropriate a large part of the pie"	Organizations formalize their interorganizational activities to legitimize them, and to make sure that they obtain "support from stakeholders to create a pie with their partner"	Organizations formalize their interorganizational activities to reach better understanding. Formalization helps to "envision the pie and the processes by which it can be created"
Representative contributions	Colombo (2003) Gulati & Singh (1998) Madhok (2002) March & Simon (1958) Mayer & Argyres (2004) Simon (1947, 1997) Sobrero & Schrader (1998) Zajac & Olsen (1993)	Klein et al. (1978) Lassar & Kerr (1996) Masten (1996) Oxley (1997) Shane (1996) Williamson (1985, 1991)	Kale et al. (2001) Meyer & Rowan (1977) Sitkin & Bies (1993) Walsh & Dewar (1987)	Ariño & Ring (2004) Avadikyan et al. (2001) Lindenberg (2003) Meindl et al. (1996) Ring & Rands (1989) Ring & Van de Ven (1989, 1994) Simons (1990, 1995) Weick (1969, 1995, 2001) Zollo & Singh (2004)

More specifically, most arguments deriving from these perspectives refer to the functions of contracts, rules and procedures, but not to the benefits associated with the process of formalization itself (for notable exceptions, see Ariño and Ring, 2004; Ring and Rands, 1989; Ring and Van de Ven, 1989, 1994; Sampson, 2003; Zollo and Singh, 2004). The customary approach has been to focus on the structure of exchange, rather than the specifics of the processes of exchange (McGinn and Keros, 2002), possibly resulting from a tendency to investigate interorganizational relationships that already exists for a while (Ring, 2000).

As is depicted in Table 5.1, articles focusing on formalization as a means to coordinate primarily build on March and Simon's theory of organizational behavior, and the more recent dynamic capabilities school (see Colombo, 2003; Gulati and Singh, 1998; Madhok, 2002). Proponents of these schools point to formalization's role in the adjustment and adaptation of partner activities, resources, and expected outputs. Authors emphasizing the control function of formalization draw support from transaction cost economics and agency theory (Lassar and Kerr, 1996; Shane, 1996; Williamson, 1985, 1991). They presume that gaining partial control over a partner organization is fundamental to interorganizational cooperation, as interests of partners rarely coincide (Blumberg, 2001; Buskens et al., 2003a), and as each of them may exhibit opportunistic behavior (Williamson, 1985, 1991). Formalization as a means of gaining legitimacy stems from institutional theory (Meyer and Rowan 1977; Sitkin and Bies, 1993; Walsh and Dewar, 1987). From this perspective, interorganizational relationships that omit formalities lack legitimate accounts of their activities, and they become vulnerable to claims that they are 'negligent, irrational, or unnecessary' (Meyer and Rowan, 1977: 350).

Whereas theories focusing on the coordination function of formal governance deviate from neoclassical theory by their analytical focus on "friction in production", theories focusing on control depart from neoclassical theory as a result of their analytical focus on "friction in exchange" (Madhok, 2002). Furthermore, whereas theories focusing on legitimacy deviate from neoclassical theory by their focus on "friction in comfort with external activities", a theory on formalization as a means to give and make sense deviates from neoclassical theory by its analytical focus on "friction in understanding and cognition" between participants in interorganizational relationships. The latter emphasizes the fact that cognitive representations of a phenomenon differ from person to person (Porac et al., 2002), and that this might result in ambiguity, equivocality, and conflicts in interorganizational relationships. This is important, as ambiguity is a fundamental problem inherent in interorganizational relationships (Carson et al., 2006), due to the fact that relationships are frequently formed in risky, uncertain settings around non-standard business objectives, posing partners for difficulties considering the assessment and comparison of each other's contributions, gains and competencies (Jap, 2001).

Objects of negotiation and formalization, for example, often entail ambiguous features and wide ranges of options, calling for participants in interorganizational

relationships to jointly frame the relationship, making sense of it as it evolves (McGinn and Keros, 2002). Moreover, interorganizational modes of organization bring together people from disparate backgrounds and with different experiences that are likely to interpret things in different ways (see Vaara, 2003). Therefore, recourse to experience will only aid participants in creating meaning to a limited extent (Balogun and Johnson, 2004). Consequently, interorganizational initiatives entail cognitive reorientations, in which sensemaking plays a central role (Gioia and Chittipeddi, 1991). The latter is particularly significant in cross-sector collaborations, which 'bring into tension and conflict extraordinarily complex ways of framing problems, as well as divergent knowledge and truth claims based on competing disciplinary paradigms....' (Couchman and Fulop, 2002: 43). Sense has to be made of the functional capabilities of potential partners, and of the differences between cultures (Barkema and Vermeulen, 1997), cognitive frames (Nooteboom, 1992), and management styles and philosophies (Lane and Lubatkin, 1998).

By complementing existing perspectives on formalization with a sensemaking perspective, we illuminate the socio-psychological processes through which participants in interorganizational relationships socially construct or 'enact' their realities (Vaara, 2003; Weick, 1995). From this perspective, the management of meaning is regarded as being critical (Maitlis, 2005), with formalization serving as a process of 'constructive clarification' (Cardinal et al., 2004: 422). Unlike the other perspectives on the functioning of formalization, the sensegiving and sensemaking function of formalization does not primarily rest on premises of bounded rationality (Simon, 1997) or opportunistic behavior (Williamson, 1985), but it relies on the presumption that partners encounter ambiguity and equivocality in their interactions, due to differences in background, experience, culture, and organizational structure. Whereas the coordination and control perspectives often evoke images of organization that centre around computation and information processing, the legitimacy and sensegiving and sensemaking perspectives emphasize meaning creation (Baum and Rowley, 2002). They stress the social-psychological processes in which organizational participants come to appreciate the potential for transacting with others that lies behind the more formal aspects of negotiation and contracting (Ariño and Ring, 2004)¹⁷. Moreover, whereas a metaphorical expression of the major arguments for the coordination, control, and legitimacy functions of formalization respectively focus on: the creation of a large pie, appropriation of a considerable piece of that pie, and legitimizing the creation of the pie, formalization as a means to give and make sense is best portrayed as assisting in *envisioning* a pie and the processes by which it can be created. Hence, in contrast to mainstream research, the sensemaking perspective does not presume that participants in interorganizational relationships know *ex ante* the nature of the pie, the size of the pie, and how to assess the processes and

¹⁷ In line with this, Hill (2001) has argued that a significant function of contract negotiation pertains to parties trying to find out what they want from the transaction and from one another. It can be largely understood as a means to reconcile parties' expectations, future actions, and consequent valuations to increase the size of the aggregate pie.

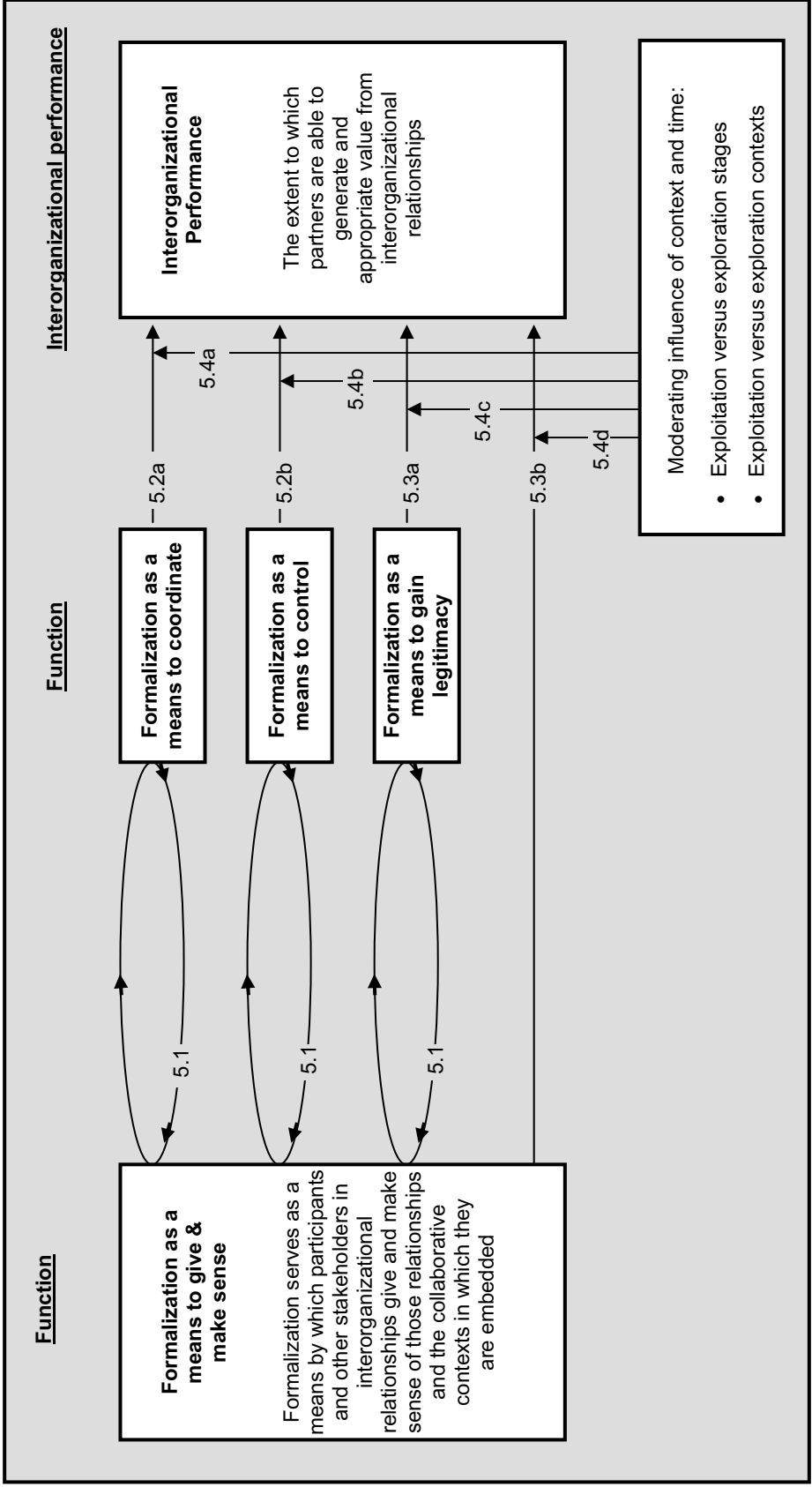
resources that create the pie (Jap, 2001). Figure 5.2 presents an integrative framework, which incorporates formalization's functions, their relationship with interorganizational performance, and the moderating effects of time and context. We elaborate on this framework in the following paragraphs.

5.3 Formalization and sensegiving & sensemaking

The arguments that we use to support formalization's functioning as a means to give and make sense serve as "bridges" between concepts that, at first sight, share little in common. After all, formalization is generally linked with routine situations, in which processes are standardized and efficiency is aimed for, whereas sensegiving and sensemaking are frequently associated with extreme conditions or crisis-situations (Weick, 1993; Weick and Roberts, 1993; Weick and Sutcliffe, 2001). Whereas formalization is connected to rationality, coercion and bureaucracy (Adler and Borys, 1996; Beck and Kieser, 2003), sensemaking is usually not. To create a better understanding of the links between both concepts, we first have to establish what we mean by sensegiving and sensemaking.

Sensemaking, a concept first coined by Karl Weick (e.g. 1969, 1979, 1993, 1995, 2001), diverts researchers' attention away from organizational structures towards processes of organizing (see also Hatch, 1999). It highlights action, activity, and creating (Weick, 1995), and refers to the reciprocal interaction of information seeking, meaning ascription, and action (Thomas et al., 1993). Sensemaking derives from the need of individuals to have a sense of identity of self in relation to others and to construct a common factual order regarding their social relationships (Turner, 1987). Sensemaking processes are therefore not only directed at identifying, assimilating and utilizing information, but also at removing its equivocality (Weick, 1995), and diminishing participants' cognitive disorder by foreclosing alternative possibilities of meaning or action (McKinley and Scherer, 2000). They consist of interactive processes by which participants in interorganizational relationships construct accounts that allow them to comprehend the world and act collectively (Weick and Roberts, 1993; Maitlis, 2005). Sensemaking thus assists in 'turning circumstances into a situation that is comprehended explicitly in words and that serves as a springboard into action (Weick et al., 2005: 409, citing Taylor and Van Every, 2000: 40). Concerted with sensemaking processes, sensegiving efforts are undertaken to 'influence the sensemaking and meaning construction of others' (Gioia and Chittipeddi, 1991: 442). These efforts consist of, among others, providing descriptions and explanations, and creating opportunities for interaction that help others to make sense (Maitlis, 2005; Weick, 1995). Sensegiving efforts by some participants in interorganizational relationships thus give rise to sensemaking efforts by others. Just like direction giving and direction seeking (Barley, 1986), sensegiving and sensemaking consist of interactional complements.

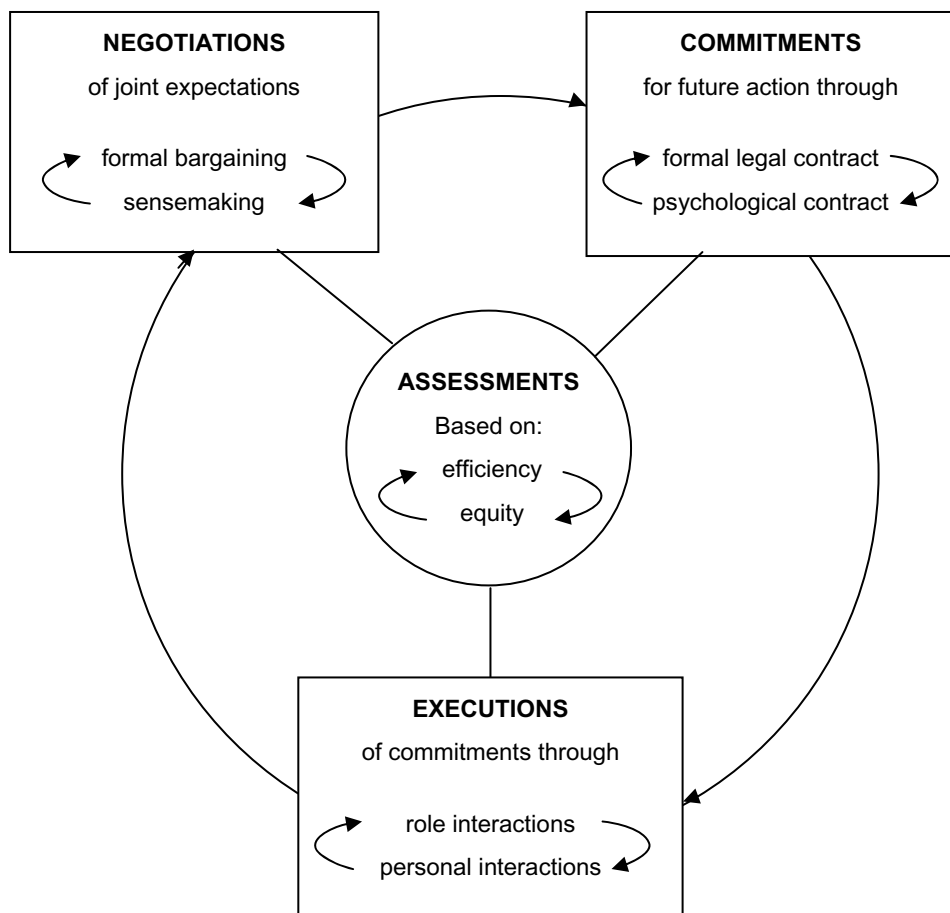
FIGURE 5.2
Integrative framework of the functions of formalization in interorganizational relationships



Sensegiving and sensemaking processes are valuable for interorganizational participants because they permit parties with 'initially different views of the purposes and expectations of a relationship to achieve congruency' (Ring and Van de Ven, 1994: 99). This is necessary because 'in many complex collaborations, the nature of the pie, its size, and an assessment of its ingredients may be ambiguous' (Jap, 2001: 86). In line with this, Weick (1995) acknowledges that some kind of structure needs to be present to guide action, and to direct attention to particular aspects of a situation. Furthermore, he notes that 'a framework of roles, rules, procedures, configured activities and authority relations' can reflect and facilitate meanings (Weick, 2001: 116). Weick also concludes that organizing and structuring purport to establish 'a workable level of uncertainty' (Weick, 1969: 40), which conforms to images of formalization as means to reduce uncertainty and ambiguity (Carson et al. 2006). He also claims that 'sensemaking and organization constitute one another' and that they involve 'labeling and categorizing' (Weick et al., 2005: 410, 411). After all, 'organization is an attempt to order the intrinsic flux of human action, to channel it towards certain ends, to give it a particular shape, through generalizing and institutionalizing particular meanings and rules' (Tsoukas and Chia, 2002: 570). Finally, Weick et al. (2005: 415) state that sensemaking involves the 'continued redrafting of an emerging story so that it becomes more comprehensive, incorporates more of the observed data, and is more resilient in the face of criticism,' which is congruent with many descriptions of the role of formalization in interorganizational relationships. However, Weick (1995: 229) also contends that 'a little order can go a long way', suggesting that detailed formalization might be superfluous.

Although these assertions suggest that formalization and sensemaking are not at odds with each other, a clear conceptualization of the link between formalization and sensegiving and sensemaking efforts is not yet available in the literature. Here we develop such a conceptualization. We start from the work of Ring and Van de Ven (1989, 1992, 1994), which indicates that interorganizational relationships differ in significant ways from markets or hierarchies, confronting researchers and managers for disparate issues. One of the most remarkable differences is that interorganizational relationships resemble new organizations in the making (Thatcher, 2004). Especially when partners have not cooperated with each other before, they lack institutionalized structures and routines (Dyer and Singh, 1998; Hoang and Rothaermel, 2005; Zollo et al., 2002), and they might have trouble in evaluating and conceptualizing their relationships, the underlying logics, and the contributions of partner organizations. Ring and Van de Ven (1989, 1994) therefore advance that cooperating organizations move through three formal stages of cooperation, which correspond with informal processes of sensemaking, understanding and committing. They presume that the development and evolution of interorganizational relationships comprises a repetitive sequence of negotiation, commitment and execution stages. Each of these stages is not only assessed on the efficiency of economic exchange, but also on the equity or "fairness" of the interaction and outcomes in relationships (Husted and Folger, 2004; Tekleab et al., 2005). Figure 5.3 depicts Ring and Van de Ven's (1994: 97) "process framework of the development of IOR's".

FIGURE 5.3
Ring and Van de Ven's process framework of the development of IOR's



Source: Ring and Van de Ven, 1994: 97

In light of our argument, the most significant contribution of Ring and Van de Ven's model (1989, 1994) is that formalization may be intricately related to sensegiving and sensemaking processes, in which participants in interorganizational relationships develop mutual expectations about their motivations, possible investments, and perceived uncertainties regarding a business deal that they are jointly exploring. During these enactment processes participants create shared understandings by lifting equivocal knowledge out of the tacit, private, complex, random, and past to make it explicit, public, simpler, ordered, and relevant to the situation at hand (Obstfeld, 2004). They 'come to appreciate the nature and purpose of a transaction with others,' and they become able to 'assess uncertainty

associated with the deal, the nature of each other's role, the other's trustworthiness [...], their rights and duties in the transaction being considered, and possible efficiency and equity of the transaction as it relates to all parties' (Ring and Van de Ven, 1994: 98). When considering the link between formalization and sensemaking, Ring and Van de Ven (1989: 185) contend that '[T]he formal process of negotiating enables, perhaps even forces, the parties to engage in sensemaking.' In this light, the negotiation of contracts can be seen as 'a process of getting to know and understand each other' (Klein Woolthuis et al., 2005: 835). A comment from Ring and Rands (1989: 350) serves as an illustration here: '[The] work involved in drafting and revising the memorandum of understanding that was done [...] may be viewed as evidence that understanding and committing processes between the organizations had been fruitful...'

Although the preceding discussion hints at a strong link between the concepts of formalization and sensemaking, Ring and Van de Ven have not offered a systematic overview of the relationships between these two constructs. They have not explicitly indicated, for example, how formalization could add to sensemaking and what the relationship with other functions of formalization might be. Furthermore, most of their work remains relatively silent on the performance implications of the sensegiving and sensemaking function of formalization, and on the conduciveness of this function of formalization to different contexts and collaborative stages of development. In the following paragraphs, we further illustrate how formalization helps participants in interorganizational relationships to give and make sense of the relationships they are engaged in. We do this by elucidating how aspects of sensegiving and sensemaking processes discerned by Weick (1969, 1979, 1993, 1995, 2001) and other authors (cf. Ariño and Ring, 2004; Nooteboom, 1992; Ring, 2000; Zollo and Singh, 2004) – such as focusing attention, reducing ambiguity, provoking interaction, forcing articulation and deliberation, and enhancing the completeness and consistency with which issues are covered – relate to the process of formalization.

Focusing attention

In early stages of cooperation, processes of sensemaking and understanding become requisite to develop common ground and to make sure that parties are on the same page (Ring, 2000). In this phase, participants in interorganizational relationships may not fully understand each other's competencies, strengths and weaknesses, and the projected outcomes of the relationship may not be clear (Jap, 2001). In this stage, negotiations turn out to be attempts at mutual sensemaking (McGinn and Keros, 2002), in which formalization serves as a kind of focusing device (Nooteboom, 1992). It assists participants in forcibly carving phenomena out 'of the undifferentiated flux of raw experience and to fix and label them conceptually (Chia, 2000: 517). It also helps them to impose order, counteract deviations, connect issues with each other, and hold events together in people's heads, providing them with meaning and direction (Weick, 2001). At this stage, formalization assists people in approaching their goals in a more systematic way, and it keeps them from focusing on other activities that sidetrack their efforts (Delmar and Shane, 2003).

Furthermore, formalization helps participants in interorganizational relationships to focus their attention by isolating and simplifying the issues with which they have to deal (Singh, 1997). As participants can direct their attention to a smaller number of activities and issues, and expend their cognitive efforts on restricted problem areas containing fewer elements and interdependencies, the cognitive complexity that they experience is reduced (Campbell, 1988). At the same time, formalization helps managers of interorganizational relationships to discover the amount of agreement they have on cause-effect linkages and on preferences for outcomes, which coincides with a description of sensemaking in its early stages by Weick and McDaniel (1989). The resulting integration and reconciliation of accounts of the relationship propagates a common, unitary basis for action (Maitlis, 2005), and reduces the co-existence of conflicting ideas and fragmented actions. John Bell, Director Corporate Alliances of Royal Philips Electronics, provides an illustration of the salience of formalization as a focusing device. He explains that *'the best you can do is have a common understanding at a certain moment, and move in that direction'* (source: comment issued at the Strategic Alliances Governance and Contracts Conference 2005, Barcelona, Spain). To recap, formalization is argued to be one of the means by which participants in interorganizational relationships focus their attention and channel others' attention to specific issues or directions, increasing their ability to give and make sense.

Reducing ambiguity

Our second illustration concerns ambiguity, to which individuals become particularly susceptible during role transitions, such as when they come to participate in interorganizational relationships. In such situations, individuals possess little motivation to act in a particular direction, except, perhaps, to ameliorate the clarity of their own situation (Lindenberg, 2003). Formalization is one of the modes of organizing by which they can achieve more clarity (Podsakoff et al., 1986), as it reduces the extent to which things can be understood or interpreted in multiple senses or ways (House and Rizzo, 1972; Weick, 1995). Formalization processes are frequently accompanied by extensive problem solving activities through which parties try to develop a better understanding of their environment (Carson et al., 2006). These activities make the structure of relationships among a set of roles and the principles that govern behavior more explicit and visible (Scott, 2003), and they afford a framework for participants to view their own contributions in light of a greater scope and context (Organ and Greene, 1981). They also assist in setting the rules of the game, clarifying the identity and positions of stakeholders, and defining the payoffs expected by cooperating parties. Formalization thereby 'provides a set of stable and comprehensible expectations' (Simon, 1997: 19) as to how participants in interorganizational relationships are doing and how they will react to what one says and does. In that sense, formalization serves both sides in a relationship 'with a clear understanding of what to expect from each other' (Narayandas and Rangan, 2004: 73), and it leads to a shared vision on the goals and objectives of a relationship (Sivadas and Dwyer, 2000). This effect of formalization is supported by Antoni Valverde, a partner in Freshfields Bruckhaus Deringer, remarking that *'the contracting process is very useful to have parties decide on what they agree*

upon' (source: comment issued at the Strategic Alliances Governance and Contracts Conference 2005, Barcelona, Spain).

Moreover, formalization may assist partners in assessing the fairness of revenue and cost divisions, something constituting an important part of interorganizational performance evaluations (Husted and Folger, 2004). Furthermore, it offers participants in interorganizational relationships a collective structure from which to construct their actions (Weick and Roberts, 1993), and it facilitates the concretization of their ideas and expectations. In addition, formalization provides parties with a measure of certainty regarding the roles and procedures for making decisions and for assessing the area of the relationship on which they can exert influence (Sivadas and Dwyer, 2000). Marginson and Ogden (2005: 437) explain that clear goals and well-specified objectives offer managers strong direction and a sense of security and clarity, 'particularly in circumstances where their role is fraught with uncertainties.' In their discussion of the role of budgets in a major UK FTSE100 based organization, they offer the following example of a manager who copes with ambiguity by holding on to formal budgets: 'I just don't know what I should be doing half the time. But, at least I know where I stand with the budget. If I keep this in order and hit the targets, and make sure my guys are doing the same, then no one can argue with that, not even the chief executive' (Marginson and Ogden, 2005: 439). In other words, ambiguity is supposed to be reduced by the formal specification of what is and what is not allowed (Carson et al., 2006; Lui and Ngo, 2004). This is supported by studies from Adler (1993), Shenkar and Zeira (1992), and Simonin (1999), and aligns with a view on formalization as a means to give and make sense in interorganizational relationships.

Forcing articulation and deliberation

On an individual level, the act of synthesizing on paper that is associated with formalization forces people to reflect, cogitate, and act heedfully (Weick, 1995; Zollo and Winter, 2002). Contracts, rules and procedures are generally given 'more deliberation than orders,' and they are often 'more carefully expressed' (Gouldner, 1954: 162). After all, the creation of formalities demands that one be very clear about the variables and parameters to be taken into account, the sequence or priority with which different criteria of decision-making are to be invoked, and the process of inference by which decisions are to be made (Katz and Kahn, 1966). An illustration is provided by a letter accompanying a royalty agreement that was sent to Avi Arad & Associates by Toy Biz Inc. The President and Chief Executive Officer of Toy Biz Inc. explained that: *'In order to insure that there are no misunderstandings regarding the royalty stream to Avi Arad & Associates it is in everyone's best interest to clarify what I believe to be our existing understanding as well as the impact of the contemplated transaction'* (source: contract issued between both parties).

Besides forcing parties to articulate their understandings of certain issues in a relationship, the sheer creation process of a formal document 'might have unexpected knowledge spill-overs in the understanding of the task' itself (Zollo and Singh, 2004: 12). Zollo and Singh (2004), for example, claim that the cognitive

effort made in codifying knowledge raises the extent to which past experience is articulated and reflected upon, which possibly results in deeper insights about the potential causal factors that are underlying observed outcomes. As formalization prompts participants in interorganizational relationships to put stimuli into frameworks, it forces them to think deeper, which may add to their understanding, and change the mental models that they carry in their heads. Formalization enables them 'to comprehend, understand, explain, attribute, extrapolate, and predict' (Starbuck and Milliken, 1988: 51). To recapitulate, formalization includes articulation, deliberation, and reflection, which jointly increase the abilities of participants in interorganizational relationships to give and make sense.

Provoking interaction and collective learning

Our fourth illustration revolves around formalization's role in instigating interaction and learning (Avadikyan, 2001; Simons, 1990, 1995). Several anecdotes illustrate that formal negotiation and contracting processes involve intense interaction. In describing negotiation and contracting efforts in an alliance between Xerox and Fuji Xerox, for example, Gomes-Casseres (1996) referred to comments by the Xerox executive in charge, who held forth that the negotiating teams left no stone unturned. He mentioned that '*a lot of bright people argued down all the alleys looking for potential future problems.*' They spent their time '*going through all the what if... questions,*' and '*took the agreement apart and put it back together*' (Gomes-Casseres, 1996: 27, italics added). Similarly, in his study of strategy formulation processes in 15 large US-firms, Simons (1990: 134-135) finds that long-range plans and budgets were 'the focus of a great deal of debate among operating managers,' and that they were used as 'agendas to discuss tactics, new marketing ideas, and product development plans throughout the organization.' These descriptions of formalization resonate with Vaill's (1976: 77) qualification of organizational designs as 'highly imperfect and tentative representations of what the world should be like [...], representations whose principal defensible function is that they trigger off debate among real men about real problems...' It appears that a primary role of formalization is to spin new stories; set actions in motion; announce beginnings, milestones, and ends; and trigger changes of course (Avadikyan, 2001; Eccles and Nohria, 1992; Weick, 1995).

By fuelling interaction, formalization helps individuals to 'express their opinions and beliefs, engage in constructive confrontations, and challenge each other's viewpoints' (Zollo and Winter, 2002: 341). Co-production of formal documents might lead participants in interorganizational relationships to share and synthesize knowledge, so that implicitly held assumptions might surface (Kotabe et al., 2003). Kale et al. (2001: 466), for example, remarked that formal documents enable sharing and dialogue, which 'facilitates creation of insights and ideas to manage future alliance situations more effectively.' Zollo et al. (2002: 703) add that as participants in interorganizational relationships work through the operational details of a collaborative agreement, they 'develop a more refined understanding of each other's cultures, management systems, capabilities, weaknesses, and so forth'. As formalization entails arguing, listening to one another, working to reconcile differences, and commitment to revisiting and updating guidelines for

action, it might also lead to deeper knowledge (see Weick, 2004), and common frames of meaning (see Weick and Roberts, 1993). Negotiation and contracting processes thereby offer 'an opportunity for the parties to come to know one another and their own and the other party's expectations about the relationship' (Hill and King, 2004: 898). Formalization thus 'accomplishes part of its purpose not just with the words agreed upon,' but also 'with the words discussed and ultimately rejected' (Hill, 2001a: 56). Moreover, formalization can lead to learning by acting as a target for contraction (Stinchcombe, 2001). By updating formal tools or systems, cooperating organizations might be able to form and redefine their understanding of the determinants of performance outcomes (Zollo and Singh, 2004), something which is less likely to take place in cases in which formalization is absent, as there is less material available to improve upon. In summary, by provoking and shaping interaction, formalization can be instrumental in allowing participants in the relationship to learn, anticipate, and adapt over time (Simons, 1990), helping them to give and make sense.

Enhancing completeness and consistency and reducing judgment errors

Finally, we wish to illustrate that formalization facilitates sensegiving and sensemaking by enhancing the completeness and consistency of the images that participants in interorganizational relationships have of the relationships in which they are engaged and of the collaborative contexts in which these are embedded. Formalization raises the likelihood that relevant information is considered, and treated properly (Naur, 1982). It helps to make sure that important elements are "taken into account", and that inconsistencies and incoherences are uncovered and eliminated (Avadikyan et al., 2001; Hafsi and Thomas, 1958). In particular, by articulating and formalizing issues, developments in people's mental models become more consistent (Forrester, 1975), reducing the likelihood that misunderstandings occur and that inadequate perceptions of interorganizational reality develop. Consistency is further enhanced by the fact that formalization requires that firms adopt relatively unambiguous proxies for desired behavior so that deviations are clearly verifiable (Carson et al., 2006). Furthermore, by both stimulating forward-looking and backward-looking at the same time (Gavetti and Levinthal, 2000) formalization might lead to the emergence of more coherent pictures of interorganizational reality. Formalization's role in enhancing the completeness and consistency with which issues are contemplated by participants in interorganizational relationships is reinforced by the fact that formalization processes are frequently sensitive to the ideas and interests of multiple persons. In as far as formalization involves the input and deliberation of several persons, it may result in a more nuanced, consummate, and consistent picture than that rendered by non-formal actions (Katz and Kahn, 1966). It may correct, for example, for deficiencies in individual thought processes, emanating from our position within social space, our tendency towards global and undifferentiated thinking, cognitive nearsightedness, and oversimplified notions of causation (Katz and Kahn, 1966; Ketokivi and Catañer, 2004). To recap, formalization may increase the levels of consistency and completeness with which issues are covered, and it may reduce the impact of individuals' judgment errors, both of which facilitate sensegiving and sensemaking.

The common denominator of the foregoing illustrations is that they indicate how structuring practices, such as formalization, render a clear and well-understood image of interorganizational relationships and the collaborative contexts in which they are embedded (see Weick, 1993, 1995; Weick and Roberts, 1993). It appears that acts of formalization drive patterns of sensemaking (Balogun and Johnson, 2004), and that they entail the potential to overcome differences in the cognitive representations possessed by participants in interorganizational relationships. Stated otherwise, formalization serves as a means by which participants in interorganizational relationships and other stakeholders give and make sense of their relationships and the collaborative contexts in which these are embedded. This description of formalization strongly resembles descriptions of sensegiving and sensemaking as “guided and controlled” processes. The advantage of such forms of sensegiving and sensemaking is that unitary and rich accounts of reality can be created, providing ‘common foundations for action’ and enabling ‘the emergence of series of actions with a consistent focus’ (Maitlis, 2005: 28).

5.4 Sensemaking versus coordination, control & legitimacy

One of Weick’s remarks suggests that formalization’s sensegiving and sensemaking function has a closer affinity with coordination, control, and legitimacy than is signified by the word *and*, as ‘to make sense of something is to begin to provide a plausible platform for sharing mental models, coordinating activities, and interacting to produce relationships’ (Weick, 2001: 95). This assertion is supported by work from Zollo and Singh (2004) indicating that formalization entails high cognitive demands in negotiation and contracting phases, which could possibly provide the basic cognitive infrastructure permitting individuals and groups to effectively integrate and coordinate their behaviors with those of others (Bigley and Roberts, 2001; see also Weick and Roberts, 1993). By formalizing issues, participants in interorganizational relationships define and frame a collaborative situation. They create ‘a solid understanding of the business, share a common fact base, and agree on important assumptions’ (Kaplan and Beinbocker, 2003: 72). This not only determines what they consider and what they ignore, but it also forms the basis for coordination, control, and legitimization efforts (see Lindenberg, 2003). After all, collaboration generally requires that participants have a view of their shared situation that is ‘fairly detailed, rich, and inclusive of the actions of other’ (Dougherty and Takacs, 2004: 578). Similarly, in order to achieve coordination, control, and legitimacy by means of formalization, it becomes almost imperative that facets of interorganizational relationships are clearly represented (Rose and Miller 1992)¹⁸, or ‘rendered knowable in a particular way’ (Townley, 1998: 193).

¹⁸ Rose and Miller (1992: 185) provide a more general account of the representation of reality by means of formalities. They contend that economic actors depend upon a huge labor of inscription, which renders reality into a calculable form. ‘By means of inscription, reality is made stable, mobile, comparable, and combinable, and it is rendered in a form in which it can be debated and diagnosed’ (Rose and Miller, 1992: 185).

Written reports, contracts, rules and procedures represent interorganizational reality in a form that is relatively stable, mobile, comparable, combinable, and calculable. They enable debate, diagnosis, management, evaluation, and programming of interorganizational issues, and help to “bring relationships into being” (Clegg et al., 2002; Rose and Miller, 1992). They create a state of the world (Hill 2001a), a collective consciousness (Clegg et al., 2002a)¹⁹, and a common reality (Hardy et al., 2005), by extending cooperating organizations’ ability to understand each other’s intentions, actions, and behavior (Aulakh and Madhok, 2002). Formalization also signals what should be monitored and in which areas ideas should be proposed and tested (Simons, 1990), and it contributes to the construction of a collective identity. The latter enables participants in interorganizational relationships to ‘construct themselves, the problem, and the solution as part of a collaborative framework in which the potential for joint action is both significant and beneficial’ (Hardy et al., 2005: 63). Formalization aimed at sensegiving and sensemaking thus reduces the cognitive disorder experienced by interorganizational stakeholders (McKinley and Scherer, 2000). This not only increases the extent to which coordination and control become possible, but it also augments participants’ comfort with the relationships in which they are involved. Consequently, the likelihood that they grant support and resources to these relationships increases. In other words, we argue that formalization’s functioning as a means to give and make sense enhances the ability of participants to coordinate, control and legitimate interorganizational activities and outcomes.

We realize that the development of formal contracts, processes, and procedures aimed at coordination of interorganizational activities, control of opportunistic behavior by partner organizations, or legitimization of the relationship with internal and external stakeholders might have unanticipated side-effects. Attempts to coordinate, control and legitimize are likely to lead to new insights, and reduce the degree of ambiguity and equivocality experienced by participants in interorganizational relationships “retrospectively”. This implies that acts of formalization aimed at giving and making sense and acts of formalization purported at one of the other functions are closely intertwined. When coordination, control, and legitimacy issues are settled by means of formalization, for example, the magnitude and number of decisions that can and have to be made is reduced, and the number of contingencies that participants in interorganizational relationships have to consider becomes severely restricted (McKinley and

¹⁹ Clegg et al (2002a), for example, argue that in accomplishing any collaborative project, parties to a contract have to interpret contractual documents. As they probably interpret these documents differently in first instance, they have to go through negotiation and contracting processes collectively to achieve a coherence model in which a collective consciousness, a shared understanding, and a common construction of interorganizational reality are created. Hardy et al. (2005: 66) notice that such common constructions of reality occur when participants ‘negotiate a general agreement regarding the causes, symptoms, assumptions, and potential solutions that relate to the issue around which the collaboration is formed’ – being an act of formalization. Such common constructions are necessary, as communication among participants is contradictory and confusing without them.

Scherer, 2000). The more restricted framing of interorganizational relationships and the collaborative contexts in which they are embedded significantly reduces the ambiguity and equivocality perceived by participants in such relationships, which subsequently facilitates sensegiving and sensemaking²⁰. Our description of the interrelationships between formalization aimed at sensegiving and sensemaking and formalization directed at the other three functions resonates with a view of administrative activity as involving a self-fulfilling prophecy (Weick, 1979, 1995). When levels of formalization aimed at coordinating activities, controlling the partner, and legitimizing the relationship are high, it becomes easier for participants in interorganizational relationships to give and make sense of the relationship and the collaborative environment, which again aids them in their efforts to coordinate, control, and legitimize. We capture this in a first hypothesis.

Hypothesis 5.1: *The higher the extent of formalization aimed at giving and making sense of interorganizational relationships and the collaborative contexts in which they are embedded, the higher will be the extent of formalization aimed at achieving coordination, control, and legitimacy, and vice versa.*

5.5 The four functions and interorganizational performance

Distinctions between the four functions of formalization become more pronounced when we consider their differential impacts on interorganizational performance. With respect to coordination and control, it has been recognized that formalization can have both positive and negative performance implications. Too little formalization might give rise to chaos, and too much formalization obstructs or impedes implementation (Miller et al., 2004), causes rigidity, and entails a loss of creativity and flexibility (Katz and Kahn, 1966; Scott, 2003; Volberda, 1998). In this respect, Mintzberg (1994: 386) notes that ‘formalization is a double-edged sword, easily reaching the point where help becomes hindrance,’ and Luo (2002: 916) remarks that ‘there exists an optimal point of contract completeness, after which its contribution to performance declines.’ In summary, excessive or dysfunctional attempts to coordinate and control are thought to impede interorganizational value creation and frustrate attempts to divide costs, risks and benefits. Such effects are exacerbated by the fact that formalization can contemporaneously stimulate the realization of potential gains by facilitating coordination, and weaken the incentives to do so by the focus on separate profit streams (Madhok, 2002). In line with this, we suppose that the use of formalization as a means to coordinate or control exhibits an inverted u-shaped relationship with interorganizational performance, which we capture in our second hypothesis.

²⁰ Elfenbein and Lerner (2003: 369) add that contract terms can have multiple effects at the same time. They state that ‘contingent payments based on product sales, new subscribers, and other measures are included in many contracts. It is possible, that these payment systems are merely sophisticated methods of dividing the agreement’s surplus. It is also possible, however, that the payment terms themselves provide important incentives to the parties and thereby affect the value of the agreement’.

Hypothesis 5.2a: *The extent to which formalization is used as a mechanism for coordination exhibits an inverted u-shaped relationship with interorganizational performance.*

Hypothesis 5.2b: *The extent to which formalization is used as a mechanism for control exhibits an inverted u-shaped relationship with interorganizational performance.*

Formalization's sensegiving and sensemaking function and formalization's legitimacy function, instead, are argued to have a positive relationship with performance, although higher levels of clarity, understanding, and legitimacy, and lower levels of equivocality are expected to demonstrate diminishing returns. Sensegiving and sensemaking efforts assist interorganizational participants in realizing the full potential of the relationships they are engaged in. They help to envision how value can be created (Ariño and Ring, 2004), and assist in removing misunderstandings, information asymmetry, and opportunities for moral hazard and opportunistic behavior that potentially disturb equitable value claiming activities by parties within interorganizational relationships. Furthermore, sensemaking and understanding may lead to a more accurate appreciation of the risks involved in a transaction, which should result in the design of more appropriate governance structures (Ring and Van de Ven, 1989), and ensue in higher interorganizational performance. Ring (2000) adds that interorganizational relationships are more likely to be efficient and equitable if parties are careful to undertake appropriate levels of sensemaking, understanding, and committing processes during the course of negotiating, transacting, and managing their relationships (Ring and Rands, 1989; Ring and van de Ven, 1989, 1994). Similarly, a certain level of legitimacy is imperative for a prolific and cooperative relationship (Kale et al., 2001), as it foresees in a higher availability of resources and more commitment to the relationship by interorganizational stakeholders. However, when ambiguity and equivocality have been removed to a considerable extent already, and when internal and external stakeholders consider the relationship as reasonably legitimate, additional sensegiving and sensemaking efforts, and further attempts to enhance the legitimacy of a cooperative endeavor, are proposed to have only marginal impacts on interorganizational performance. More thorough clarification by means of formalization can only lead to small refinements in participants' images of value creation opportunities, while additional attempts to legitimize the relationship only reinforce the confidence and validity already attributed to it. As benefits are particularly high at low degrees of formalization for both the legitimacy function and the sensemaking function, and as increases in the degree of formalization lead to higher costs, the net effect of both forms of formalization may best be depicted by an inverted u-shaped function that exhibits a very steep course of development in the beginning, and a very long right-hand tail. These assertions are captured in hypothesis 5.3.

Hypothesis 5.3a: *The extent to which formalization is used as a means to legitimize an interorganizational relationship has an inverted u-shaped relationship*

with interorganizational performance, exhibiting a very steep course of development in the beginning, and a very long right-hand tail.

Hypothesis 5.3b: *The extent to which formalization is used as a means to give and make sense of interorganizational relationships and the collaborative environments in which they are embedded has an inverted u-shaped relationship with interorganizational performance, exhibiting a very steep course of development in the beginning, and a very long right-hand tail.*

5.6 Moderating effects of time and context

The foregoing arguments do not indicate which functions of formalization are most conducive to various collaborative contexts and stages of interorganizational development. To obtain insights on this issue, we here distinguish between exploration and exploitation context and exploration and exploitation stages (Koza and Lewin, 1998; March, 1991; Rothaermel and Deeds, 2004). These moderators are simultaneously discussed here, as interorganizational activities tend to shift from exploration towards exploitation over time (Rothaermel and Deeds, 2004). Innovations and new initiatives, for example, eventually require commercialization. Furthermore, learning tends to take place, which raises the efficiency with which partners jointly deploy their resources (Dyer and Singh, 1998; Zollo et al., 2002). Having presumed this, we expect that the need for each of the four functions, and the ability to fulfill these needs by means of formalization differ for exploration and exploitation contexts, and stages of development. To construct our argument further, we have to clarify what we mean by exploration and exploitation. Exploration involves innovation, risk taking, building new capabilities, learning, and entering new lines of business (Koza and Lewin, 1998). In exploratory contexts and stages of development, employees need “slack” to discover, innovate, discuss, and experiment (e.g. March, 1991). Partners are primarily assessing each other’s competencies and the value of interaction (Jap and Ganesan, 2000), and they try to develop understandings of their new situation (Ring, 2000). Exploitation, on the other hand, is associated with enlarging the productivity of capital and assets by improving and refining existing capabilities and technologies, standardization, routinization, and systematic cost reduction (Koza and Lewin, 1998; March, 1991; Rothaermel and Deeds, 2004). The general thrust of our argument is then, that formalization is focused consecutively on facilitating sensegiving and sensemaking, and increasing interorganizational legitimacy in exploration stages and contexts, while aiming at coordination and enabling control in exploitation stages and contexts.

In exploration stages and contexts, the need for sensegiving and sensemaking and the need for legitimacy are most salient, as expectations of prospective partners might be incompatible (Mjoen and Tallman, 1997), and differences in background, experience, and culture can lead to ambiguity, equivocality, and conflict (see Jemison and Sitkin, 1986). Moreover, in early stages of development, multi-organizational projects rarely involve a high degree of coherence and unity of purpose (Flyvbjerg, 1998), and participants in the relationship still have to come to

appreciate the potential for transacting with each other (Ariño and Ring, 2004). Organizations are 'testing the goal compatibility, integrity, and performance of the other, as well as potential obligations, benefits, and burdens involved with working together on a long-term basis' (Jap and Ganesan, 2000: 244). This is even more pertinent in cross-sector collaborations, which often 'bring into tension and conflict extraordinarily complex ways of framing problems, as well as divergent knowledge and truth claims based on competing disciplinary paradigms....' (Couchman and Fulop, 2002: 43). Especially in these situations, the creation of coherent understandings that enable collective action is important and challenging (Maitlis, 2005; Weick, 1993). In the exploration stage, formalization can thus assist in determining whether interorganizational members have a common understanding (Simon, 1997), and whether there are decisions that need to be made and what those decisions might consist of (Weick, 2001). Besides, formalization can prevent parties from simply starting a relationship immediately, without a solid basis. By forcing articulation of issues critical to alliance success, such as goals, frameworks to deal with unexpected contingencies and explicit expectations of each partner, formalization can temper hubris and faddishness, and assist organizations in considering the consequences of engaging in a relationship (Sampson, 2003). This effect is particularly pronounced for organizations with little common history to rely on (see Weick, 2001). Findings from Fryxell et al. (2002) indicating that formal controls have a more positive relationship with international joint venture performance in younger rather than in older relationship provide support for the fact that sensemaking and legitimacy are functions of formalization that are particularly relevant in early stages of cooperation. As partners get to know each other better and information asymmetries are being reduced, the need for signaling and sensemaking diminishes (Heide, 2003).

In the exploitation stage, the basis for the relationship has been defined. In this stage, issues become more clear-cut (see Koza and Lewin, 1998; Rothaermel and Deeds, 2004). Parties to the relationship are likely to have a reasonable picture of the business proposal underlying their collaboration, and they have developed joint understandings that allow for uniquely efficient communication in the form of idiosyncratic interaction routines (Dyer and Singh, 1998; Hoang and Rothaermel, 2005; Kotabe et al., 2003; Zollo et al., 2002). They have also come to know more about each other's structure, operations and competencies (Shenkar and Zeira, 1992), which enhances their ability to formalize (e.g. see Mayer and Argyres, 2004; Poppo and Zenger, 2002). In this respect, Zollo et al. (2002: 703) note that a 'key body of knowledge accumulated during alliance activity concerns the partnering organizations themselves' reducing the need for sensemaking and sensemaking in exploitation contexts and stages. This can be illustrated with Ring's (1997) description of collaborations between 3M, NASA and a firm called Beta Trading, in which early stages of negotiation and commitment had resulted in trust, a free flow of information, speaking the same language, and mechanisms for private ordering. Ring (1997: 298) concluded that, as a result, 'the need for extensive sensemaking, understanding, and committing processes during administrative phases was [...] reduced.' In general, he notes that once the details of a cooperative interorganizational relationship are established in the

transactional phases, 'sensemaking and understanding processes, although ongoing, will be less intense than those that occur during transactional phases, at least until problems arise' (Ring 1997: 299).

Conversely, in exploration stages and contexts, interorganizational relationships are sometimes hardly amenable to management – that is, installation and implementation of coordination and control mechanisms is usually inappropriate – as participants in interorganizational relationships still need to form themselves cognitive representations of the relationship. In these situations, formalization aimed at coordination and control is not very beneficial, because expected returns and activities might be highly variable and very unclear (Cardinal, 2001; March, 1991; Rothaermel and Deeds, 2004), and because formalities may discourage creative ideas and innovative developments. This assertion coincides with Oxley's (1997) observation that if the purpose of a contract or alliance is the creation rather than exploitation of technology, adequate specification of rights will inevitably be problematic. Child (1975: 13) adds that 'in conditions of high variability in the environment, successful performance is likely to depend on [...] avoidance of heavily formalized systems of organization, in so far as these are built upon standard procedures and red-tape which tend to shape activities on precedence rather than of new changing requirements.' In these situations, interorganizational partners might feel the need for coordination and control, but they simply lack the ability to design appropriate formalities (Gerwin, 2004; Helm and Kloyer, 2004). Exploitation contexts and stages, instead, are frequently associated with the transformation and exploitation of existing knowledge, which is facilitated by formalization (Jansen et al., 2005). As the exploitation of simple strategies and existing knowledge demands predictability, control, and high degrees of conformity, interorganizational partners become more inclined to use rules and other formal control mechanisms to attain coordination and control. Consequently, we propose that formalization as a means to give and make sense has a more positive influence on interorganizational performance in exploratory contexts and stages of development, compared to exploitation contexts and stages of development. In contrast, we expect that the relationship between formalization as a means to coordinate and control is less positive in exploratory contexts and stages of development compared to situations characterized by exploitation. These assertions are captured in hypotheses 5.4a to 5.4d.

Hypothesis 5.4a: *The relationship between the extent of formalization aimed at coordination and interorganizational performance is negatively (positively) moderated by the degree to which these relationships take place in exploratory contexts (exploitation contexts), and the degree to which they are in their exploratory stages (exploitation stages).*

Hypothesis 5.4b: *The relationship between the extent of formalization aimed at control and interorganizational performance is negatively (positively) moderated by the degree to which these relationships take place in exploratory contexts (exploitation contexts), and the degree to which they are in their exploratory stages (exploitation stages).*

Hypothesis 5.4c: *The relationship between the extent of formalization aimed at achieving interorganizational legitimacy and interorganizational performance is positively (negatively) moderated by the degree to which these relationships take place in exploratory contexts (exploitation contexts), and the degree to which they are in their exploratory stages (exploitation stages).*

Hypothesis 5.4d: *The relationship between the extent of formalization aimed at sensegiving and sensemaking and interorganizational performance is positively (negatively) moderated by the degree to which these relationships take place in exploratory contexts (exploitation contexts), and the degree to which they are in their exploratory stages (exploitation stages).*

5.7 Discussion

This theme was born out of the observation that understanding ‘why economic agents use contracts [...] is crucial to understanding the organization and efficiency of economic exchange’ (Masten and Saussier, 2002: 273). It was denominated “functions of formalization”, because it concerned the underlying reasons or rationales for instituting formal interorganizational structures and practices. In this chapter, we have taken issue with the observation that existing studies tend to focus either on formalization as a means to coordinate, a means to control or a means to legitimize (see for instance Gulati and Singh, 1998; Madhok, 2002; Meyer and Rowan, 1977; Salbu, 1997; Kale et al., 2002), generally passing over the fact that formalization might have other functions (e.g. for notable exceptions see, for example, Ariño and Ring, 2004; Lindenberg, 2003; Zollo and Singh, 2004). Closer inspection of the functions of formalization appeared necessary, as several authors suggest that there is a need for alternative explanations and novel understandings of formal structures and practices (Hatch, 1999; Meyer and Rowan, 1977; Simons, 1990, 1995). Moreover, as we expected that multiple functions of formalization co-exist, it became requisite to examine how these functions are related to each other (see Madhok, 2002), how they influence interorganizational performance, and in which contexts and for which temporal stages each of the functions is most important. We captured these considerations in the following research questions.

RQ3: What are the functions of formalization?

RQ4: How do these functions relate to each other?

RQ5: What is their relationship with interorganizational performance?

RQ6: What is the relative importance of each of these functions in different collaborative contexts and stages of interorganizational development?

Key findings

By embracing broad conceptual categories, we were able to theorize beyond the narrow boundaries of single theoretical lenses supportive of the coordination,

control, and legitimacy functions of formalization. We argued that formalization assists participants and stakeholders in interorganizational relationships in giving and making sense of relationships and the collaborative contexts in which they are embedded. We showed how formalization accommodates several distinguishing features of sensemaking such as 'its genesis in disruptive ambiguity [e.g. the initiation of a new relationship], its beginnings in acts of noticing and bracketing [e.g. writing things down], its mixture of retrospect and prospect [e.g. looking forward and looking backward] [..., and] its culmination in articulation that shades into acting' [formalization as a basis for coordination and control] (Weick et al., 2005: 413). We also advanced that formalization's sensegiving and sensemaking function is more pronounced in exploratory contexts and early stages of cooperation, whereas the coordination and control functions of formalization dominate in exploitation contexts and later stages of development. In conclusion, the chapter moves beyond formalization's functions of coordination, control and legitimacy, thereby opening up a new way of thinking about the meaning of formalization for the management of interorganizational relationships.

Theoretical and practical implications

Our description indicates that research on formalization in interorganizational relationships may benefit from embracing the inherent qualities of the process of formalization itself, and from changing its focus on contracts, rules and procedures to an emphasis on the processes from which these formalities originate (see also Langley, 1988; Mintzberg, 1994). Besides, our exposition serves to redirect researchers' attention from coercive towards enabling types of formalization (see Adler and Borys, 1996; Zollo and Winter, 2002) in which higher levels of understanding (Zollo and Singh, 2004) and the constitution of meaning (Giddens, 1984) take up a more central position, and for which assumptions of opportunism and self-interest are no longer imperative. Moreover, as we have shown that formalization can assume diverse functions, in future, any act of formalization must be considered as ambivalent in the sense that it is a vehicle of several functions (Avadikyan, 2001). Consequently, more research attention could be directed to the intentions underlying managers' decisions to formalize, and to the interpretations that partners give to each other's actions. Chalos and O'Connor (2004) show that such research is promising. In their study on control mechanisms in US-Chinese joint ventures, US partners viewed particular controls to be useful for the selective transmission and protection of their knowledge, while Chinese partners viewed the same controls as a means to protect their relation-specific investments. Furthermore, our conceptualization of formalization rejects common beliefs that the degree of formalization necessarily has to be low in uncertain situations for which measurability is low (Galbraith, 1973; Lassar and Kerr, 1996; Ouchi, 1979; Poppo and Zenger, 2002; Shane, 1996; Williamson, 1985). Although we acknowledge that this might hold for formalization directed at coordination and control, we suggest it does not apply to formalization aimed at increasing legitimacy or at enabling sensegiving and sensemaking (see also theme one). We even argued that these functions of formalization are probably more salient in ambiguous and exploratory contexts, thereby creating a plausible account for acts of formalization that appear inappropriate from coordination, control or legitimacy

perspectives. The co-existence of each of the four functions and their interrelationships indicates that formalization tends to serve a number of functions at the same time (Foss and Foss, 2005; Madhok, 2002), and that either-or discussions on formalization's functioning are probably unproductive (Klein Woolthuis et al., 2005). This implies that researchers and practitioners should not let one perspective on formalization rule their thinking.

Limitations and opportunities for future research

Several opportunities for future research arise. First, we encourage attempts to test our framework empirically. Researchers conducting these tests should preferably make use of research settings in which surveys, observations, interviews and document analyses are combined, because such an approach is likely to offer more varied insights on formalization's functioning. Another avenue for further research could be to investigate to what extent escalating momentum in interorganizational relationships may prohibit formalization's sensemaking function to come to fruition. Analogue to acquisitions (Jemison and Sitkin, 1986), for example, participants in interorganizational relationships may exhibit an escalating desire to complete formation processes quickly, which may result in premature solutions, limited consideration of integration issues, and a lower chance to attain successful outcomes (see Jemison and Sitkin, 1986). Finally, our review of the functions of formalization shows that there is room for some consolidation, or 'at least some potential for bridges between, and a fruitful dialogue among the seemingly diverse contributions to the study of interorganizational relations' (Oliver and Ebers, 1998: 570). In particular, other theories than those described in this chapter may be subsumed under the coordination, control, legitimacy or sensemaking perspectives distinguished here.

6 THEME 3 – DUALITY & DIALECTIC TENSIONS

'From a dialectical perspective, then, specific theories are not in any simple sense to be set aside. Rather they are to be superseded in a more encompassing framework.'

Benson, 1977: 17

Summary

Generic perspectives on the role of formalization in interorganizational relationships presume that contracts, rules and procedures are directed at coordination and control, and that their influence on interorganizational performance is contingent upon firm-level and transaction, or relational level factors. In response to recent calls for research on dialectics in interorganizational relationships (De Rond and Bouchikhi 2004; Vieira da Cunha et al. 2002), a complementary perspective on formalization is being developed. We propose that alliance managers face a duality when deciding which degree of formalization is most appropriate for their relationships, as they simultaneously anticipate various functions and dysfunctions of formalization. The actual degree of formalization pertaining to collaborative relationships is therefore likely to eventuate in dialectic tensions that have to be managed. A case study of an alliance between a major European financial services firm and one of the world's leading retailers reveals that alliance managers capitalize on these tensions in at least three ways. First, they alternately emphasize different formalization-requirements by each of the partner firms. Second, they refer to factors largely beyond their own control when justifying their decisions to formalize. Finally, they apply a kind of semi-structures, by avoiding concurrent formalization of outcomes and processes. These findings illustrate that a dialectic perspective offers a promising complement to existing perspectives on the role of formalization in interorganizational relationships.

6.1 Introduction

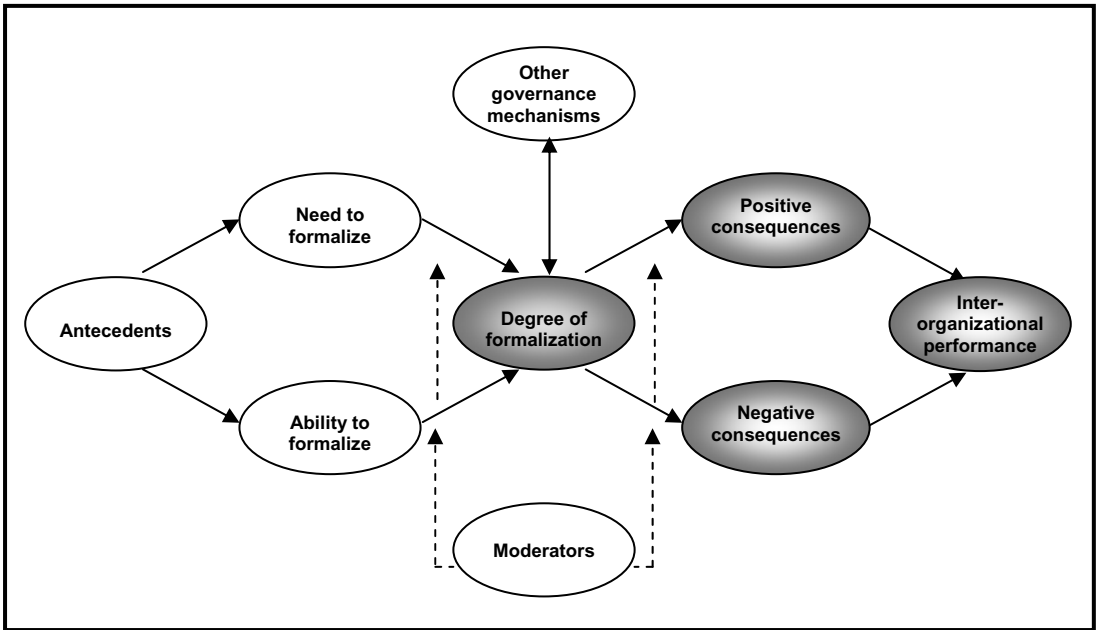
Although originating from studies on an intra-organizational level, researchers in the field of interorganizational management have become more and more interested in the concept of formalization and its myriad manifestations (e.g. see Grandori, 1997; Luo, 2002; Poppo and Zenger, 2002; Sampson, 2003; Williamson, 1985). Hitherto, the majority of these studies exhibit a rather mechanistic character, paying little attention to the issues alliance managers face when deciding on the extent to which contracts, rules and procedures have to be applied. Explanations of the degree to which contracts, rules and procedures are applied in interorganizational relationships derived from, among others, behavioral theory, the dynamic capabilities school, transaction cost theory, and agency theory all refer to 'operational contingencies' (see Child, 1997). These theories presuppose that levels of formalization have to be aligned with transaction, organization, or contextual characteristics and attributes, in order to guarantee that appropriate levels of coordination and control are exercised, and to fuel interorganizational performance (e.g. Gulati and Singh 1998; Williamson, 1985).

Such perspectives confine management's role to guaranteeing optimal alignment, and they do not explicitly recognize the intervening quality of decision-making (Child, 1997). They remain agnostic to the fact that structural situational characteristics can only have consequences for the governance of interorganizational relations through managerial actions (Noorderhaven et al., 1998). Barley (1986), for example, found that managerial actions can act as strong mediators between structures and contextual and technological characteristics that are believed to influence those structures. This provokes the question as to how our understanding of the relationship between formalization and interorganizational performance would change, if more attention were granted to managerial choice.

Consistent with conceptualizations of formalization as being the result of a trade-off (Galbraith, 1977; Goold and Quinn, 1990; Heide, 1994), and in response to recent calls for inquiries into a dialectic perspective on interorganizational cooperation (e.g. Das and Teng, 2000; De Rond, 2003; De Rond and Bouchiki, 2004; Vieira da Cunha et al., 2002), we develop a complementary perspective on the role of formalization in interorganizational relationships. We regard interorganizational relationships as a unity of opposites (see Das and Teng, 2000), implying that interorganizational managers are confronted with 'contradictory values which compete with each other' (Van de Ven, 1992: 178). We also embrace the possibility that formalization concurrently exhibits functions and dysfunctions (e.g. see Blau, 1955; Cardinal et al., 2004; Das and Teng, 1998; Luo, 2002; Mintzberg, 1994; Poppo and Zenger, 2002). In line with this, we argue that managers of interorganizational relationships anticipate certain functions and dysfunctions of formalization, and that their decisions to formalize eventuate in dialectic tensions that demand managerial attention. In this chapter, we therefore focus on the areas that have been shaded in the research framework depicted in Figure 6.1. We primarily pay attention to the positive and negative consequences of formalization and the tension that arises due to their co-existence, and we ask ourselves how managers of interorganizational relationships cope with tensions arising from the co-existence of formalization's functions and dysfunctions?

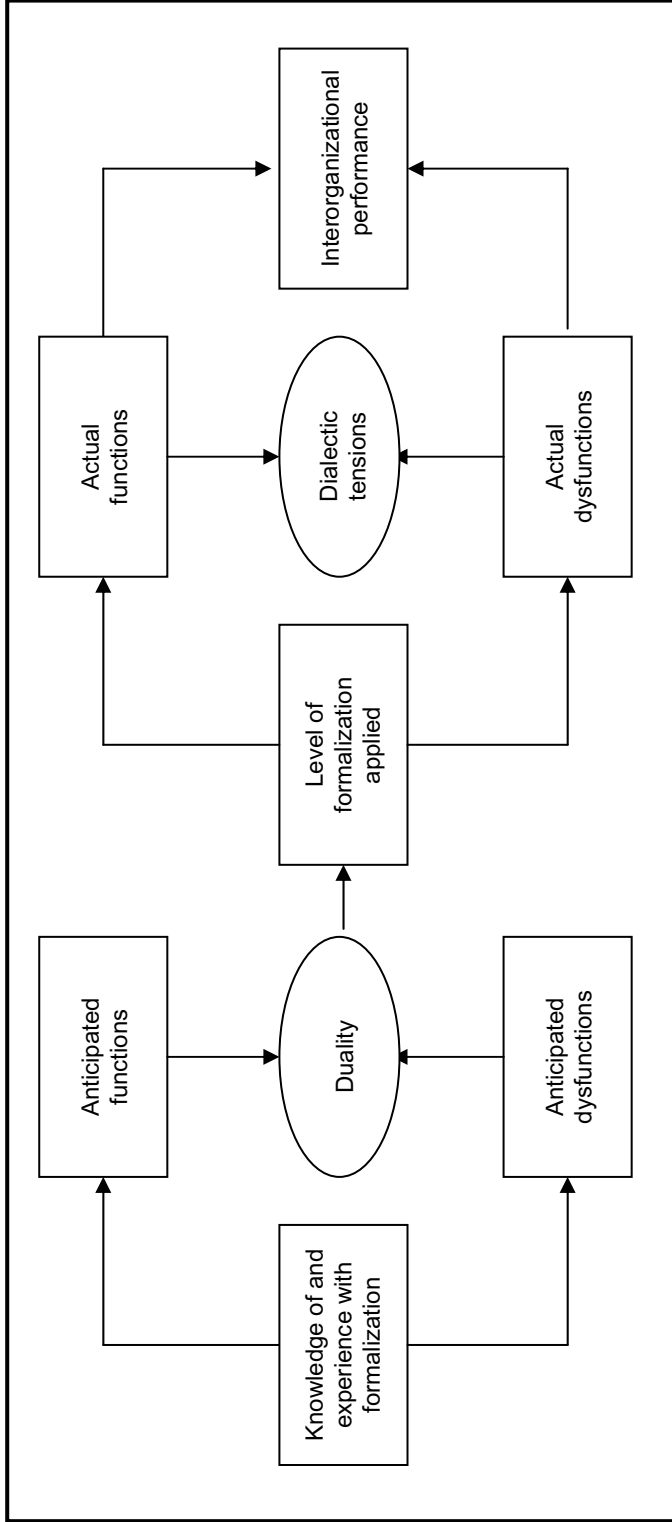
By investigating this issue, we make two distinctive contributions to the literature on interorganizational governance. First, based on the conceptual framework presented in Figure 6.2, we furnish an overview and categorization of the functions and dysfunctions of formalization. This overview elucidates the duality with which managers of interorganizational relationships are confronted when deciding on the level of formalization that is most appropriate for the relationships they manage. Our description of this duality offers a more realistic and robust view of interorganizational cooperation than is offered in more "traditional" perspectives (see Osborn and Hagedoorn, 1997). We move beyond the coordination and control effects of formalization commonly put forward in the literature (e.g. see Gulati and Singh, 1998; Madhok, 2002; Salbu, 1997), and illuminate formalization's linkages with cognition and learning, legitimacy, and long-run developments. Our review reveals that formalization is still relevant, but has partly assumed new meanings (consistent with Vieira da Cunha et al., 2002).

FIGURE 6.1
Research framework – theme three



Second, and congruent with calls from Hatch (1999) and work by Meyer and Rowan (1977), we offer alternative ways of looking at organizational structures and structuring practices. We complement coordination and control perspectives on formalization, which presume that the level of formalization is contingent upon contextual attributes and task characteristics (see Child, 1997), with a dialectic perspective, emphasizing management's role in coping with the tensions emanating from formalization's dual character. Like Katz and Kahn (1966: 222) we are both led to an attitude of great respect for formal organization, while at the same time we face up to its deficiencies. Our findings suggests that interorganizational performance is not solely the resultant of formalization's functions and dysfunctions, but also of managers' ability to cope with the tensions emanating from its inherently dual character. In this sense, introducing a dialectic perspective adds an extra theoretical layer to the study of structuring processes in interorganizational relationships. Although the interorganizational literature is 'relatively void of dialectical approaches' (De Rond and Bouchiki, 2004: 58), juxtaposing such a perspective alongside the mainstream literature provides the theoretical depth needed to fully exemplify the competing forces eventuating from it (Das and Teng, 2000). A dialectic perspective has the advantage of being comprehensive and integrative (Das and Teng, 2000; Quinn, 1988). It enables one to address tensions stemming from the simultaneous existence of several apparent inconsistencies (Van de Ven and Poole, 1995), and resonates with pleas for more research on the co-evolution of organizations and their partners (Koza and Lewin, 1998; Volberda and Lewin, 2003).

FIGURE 6.2
A dialectic perspective on formalization in interorganizational relationships*



* See Table 1 for the functions and dysfunctions that have been attributed to formalization

The chapter is organized according to the following structure. First, based on Figure 6.2, we explain what is understood by a dialectic perspective on formalization, and we indicate how it differs from the generic perspectives currently prevailing in the literature. Subsequently, we provide an overview of the functions and dysfunctions of formalization, which stand at the basis of such a dialectic perspective. Following this, we present a case study of an alliance between a major European financial services organization and one of the world's largest retailers, which has been established to distribute financial services throughout a retail channel. The case provides an illustration of the dialectic perspective on formalization presented in Figure 6.2. Consistent with De Rond and Bouchiki (2004: 67), it demonstrates how alliance managers capitalize on the tensions between formalization's functions and dysfunctions, a process that helps to 'shape an alliance trajectory.' We show that alliance-managers capitalize on these tensions in at least three ways.

6.2 Dialectic versus coordination & control perspectives

Coordination and control perspectives on formalization, in general, have caused researchers to strive to determine what are the single best governance solutions for particular relationships (Long et al., 2002), and it has led them to argue that a particular level of formalization should be used over another, depending upon a given activity or context (Eisenhardt, 1985; Ghoshal and Moran, 1996; Ouchi, 1979)²¹. For example, transaction costs economists (e.g. Klein, 2000; Klein et al., 1978; Williamson, 1985) have put forward that formalization and other governance efforts are determined by transaction characteristics such as levels of uncertainty, asset-specificity, and the frequency with which partners exchange goods or services. Agency theorists, forming another example, have argued that the extent of formalization that is applied depends on the measurability of a transaction, and on organizations' abilities to specify tasks (Eisenhardt, 1989b). Furthermore, advocates of dynamic capabilities and competence schools (e.g. Colombo, 2003) suggest that governance efforts, including formalization, are contingent upon the capabilities and competences of the partners involved in a relationship. Proponents of several other schools follow similar lines of reasoning, contending that the level of formalization applied is determined by, and has to be aligned with, transaction, organization, or contextual characteristics and attributes (Child and McGrath, 2001; Noorderhaven et al., 1998).

In such studies, differentiation models are used that polarize contradictory perspectives in an effort to ascertain which position is correct (Peng and Nisbett, 1999). Relationship between formalization and context and task characteristics are either found or not found, and contradictory perspectives are not allowed to creep

²¹ Theories generated by administrative researchers exhibit a serious shortcoming in that they do not take into account that managers of excellent companies seem to have a capacity for dealing with paradox. 'In order to be internally consistent, theories tend to eliminate contradiction' (Quinn, 1988: 27).

in, or they are simply rationalized and solved (Farson, 1996). However, by doing so, we fail to sustain the tension inherent in most managerial problems. This can lead to schismogenesis, 'a process of self-reinforcement in which attributes of the organization perpetuate themselves until they become dysfunctional' (Volberda, 1998: 75)²². Besides, it merely leads to a focus on the origins of structuring choices, neglecting arguments of Merton (1957) and Blau (1955) for investigating the consequences of structuring choices. In this spirit, Friedberg (2000) calls for abandoning the either-or syndrome, and Child and McGrath (2001: 1144) argue that scholars 'must learn to allow contradictions to remain, stepping away from the modernist principles of alignment and congruence.'

Adopting a dialectic perspective, in contrast, denotes awareness of the simultaneous presence of opposites, and the replacement of either-or conceptions with both-and constructs (Lewis, 2000; Van de Ven and Poole, 1995). In line with this, formalization is conceptualized separately from its functions and dysfunctions (Blau, 1955; Merton, 1957), and from interorganizational performance (see Figure 6.2). We thus take the position that formalization's consequences are not inherently positive or negative, and that singular functions or dysfunctions do not constitute interorganizational performance in its entirety. The latter results in an extension of existing conceptualizations of dialectic tensions, in which broad terms, such as "competition" and "cooperation," "stability" and "change", or "flexibility" and "control" are set off against each other (see Das and Teng, 2000; De Rond and Bouchikhi, 2004; Volberda, 1996, 1998; Yan and Gray, 2001). Moreover, we suggest that alliance managers anticipate various functions and dysfunctions of formalization when contemplating on the degree of formalization that is most appropriate for the situation at hand. They face a duality, as formalization has apparently contradictory effects on interorganizational performance (for arguments on the dual character of "flexibility", which is often depicted as formalization's antipode, see Volberda, 1996). The functions and dysfunctions of formalization that they anticipate are expected to be based on managers' knowledge of and experience with formalization, something resonating with more general arguments on the effects of previous experience with various structuring practices on interorganizational performance (McGahan and Villalonga, 2003). In the alliance capability literature, for example, it is suggested that the influence of alliance experience on interorganizational performance is mediated by an organization's alliance capability (Draulans et al., 2003; Eisenhardt and Martin, 2000; Kale et al., 2002; Zollo and Winter, 2002). We expect that firms with more developed collaborative capabilities, and firms that have more experience with interorganizational cooperation know better what they are doing when embarking on new initiatives. This implies that formalization is not only triggered by objective factors, but also by social dynamics (see Barley, 1986).

²² We have to note that 'thinking about contradiction is not a natural inclination. It requires counterintuitive processes' (Quinn, 1988: 26). The natural tendency for people socialized around Western thought is to be "Schismogenic," a term referring to arguments, theories, or perspectives in which one of two opposing but connected values is chosen over another (we prefer a pluralistic perspective, witnessing previous chapters).

As is depicted in Figure 6.2, we subsequently propose that the level of formalization that is actually applied entails several functions and dysfunctions, including unanticipated or latent consequences of formalization (see Barley, 1986; Blau, 1955; McKinley and Scherer, 2000). These functions and dysfunctions of formalization have previously been argued to jointly determine interorganizational performance. In particular, several authors have depicted the relationship between formalization and interorganizational performance as an inverted curve-linear path, presuming that too little formalization gives rise to chaos and that too much formalization leads to rigidity and a loss of creativeness (Katz and Kahn, 1966; Scott, 2003). In this respect, Mintzberg (1994: 386) notes that 'formalization is a double-edged sword, easily reaching the point where help becomes hindrance,' whereas Luo (2002: 916) suggests that '...there exists an optimal point of contract completeness, after which its contribution to performance declines.' In this chapter, we reveal that the management of tensions arising from the co-existence of functions and dysfunctions of formalization constitutes an additional factor influencing interorganizational performance. We suggest that the influence of dialectic tensions on interorganizational performance is moderated by alliance managers' abilities to capitalize on these tensions. This coincides with a description of managerial efforts directed at reducing the impact of dysfunctions on performance by Blau:

'When a social pattern has a series of consequences, its dysfunctions may be looked upon as the social costs of its contributions. Presumably, once the costs outweigh the functions, the pattern will be abandoned. Often, however, social action is more constructive and less patient. People attack troublesome conditions, even if they cannot, or will not eliminate the factors that produced them, and without waiting for a negative balance of their consequences' (Blau, 1955: 13)

By doing so, we do not neglect that formalization might have more positive contributions to interorganizational performance in certain contexts and for certain task characteristics (see, for example, Burns and Stalker, 1961; Frederickson, 1984; Frederickson and Mitchell, 1984), and that the number and magnitude of functions and dysfunctions may change over time (see, for instance, Cardinal et al., 2004). However, we presume that some tensions arising from formalization are simply inevitable or permanent. They stem from contradictory forces that are present simultaneously, beyond the will or power of management, and they have to be recognized and managed (Clegg et al., 2002b; Huxham and Beech, 2003). Formalization is simply expected to have dysfunctions in almost every situation, as '...an inevitable set of outcomes of administrative processes are conflict, misunderstanding, and changing expectations' (Ring, 1997: 294). Internal or external stakeholders such as boards of directors or financiers, for example, might impose high levels of formalization, on a relationship. In that case, formalization probably fulfills a control function, but it might be dysfunctional at the same time, introducing rigidity in decision-making and provoking attempts of participants in collaborative relationships to cover themselves against all kinds of risks, and to pass on responsibilities. Similarly, formalization aimed at coordination and control has regularly been found to have unintended or unanticipated consequences

(Blau, 1955; Cardinal et al., 2004; Mintzberg, 1994), which are hard to circumvent or alleviate. It is not unthinkable, for instance, that formalization purported at enhancing the stability of a relationship and at minimizing the adverse effects of employee turnover (see De Rond, 2003), concurrently leads to distrust by a partner organization (Ghoshal and Moran, 1996) and a reduction in the partners' ability and willingness to adapt to change (Luo, 2002; Mintzberg, 1994). Congruent with this observation, formalization is sometimes presented as an oxymoron (Bijlsma-Frankema and Koopman, 2004), reminiscent of contracts, rules and procedures that unintendedly take up the character of an iron cage (DiMaggio and Powell, 1983). By accepting the co-presence of opposites instead of adhering to extremes (Eisenhardt, 2000; Van de Ven and Poole, 1995), it becomes possible to understand how alliance managers cope with the tensions inherent in their structuring choices and how they capitalize on the tensions between the functions and the dysfunctions of formalization.

Applying such a view involves the observation of the principles of simultaneity, locality, minimality, and generality (Benson, 1977; Vieira da Cunha et al., 2002). According to Vieira da Cunha et al. (2002), simultaneity means that we accept views that are grounded on the interplay between contradictory forces and not on attempts to subdue one view to another. Locality implies that the synthesis between two opposing poles of formalization's effects results from case-by-case enactment. This suggests that managers have to cope with tensions in their daily activities, and that these cannot be solved or forestalled completely by clever organizational design. Minimality conveys that the ability to use the tensions between opposite poles derives from maintaining sufficient levels of each of the poles in order to avoid one taking over the other. Extreme levels of formalization, for example, have been argued to be less desirable than intermediate levels (Luo, 2002; Mintzberg, 1994). Extremely low or high levels of formalization do not offer room for alliance managers to maneuver and cope with tensions, or they create tensions of a magnitude that are hardly amenable to management. Finally, generality pertains to the fact that the prescriptions used for managing tensions have to apply to a large range of situations (Vieira da Cunha et al., 2002).

6.3 Functions and dysfunctions of formalization

In this paragraph, we discern formalization's functions from its dysfunctions. Functions are defined as 'observed consequences of social patterns that change existing conditions in the direction of socially valued objectives,' whereas dysfunctions, conversely, are 'those observed consequences of social patterns that change existing conditions in the direction opposite to socially valued objectives or consequences that interfere with the attainment of valued objectives' (Blau, 1955: 11). Before describing the various functions and dysfunctions associated with formalization, we note that functions of formalization can turn into dysfunctions in case extreme levels pertain. After all, distinctions between functions and dysfunctions eventually rest on value judgments (Blau, 1955). Formalization directed at coordination and control, for example, can turn into formalism, rigidity and inflexibility, while formalization aimed at legitimacy can

evoke suspicion and irritation. The distinction we make between formalization's functions and dysfunctions does not become irrelevant, but one has to bear in mind that what seems to be a function can easily turn into a dysfunction (see Leonard-Barton (1992), and Hoang and Rothaermel (2005) for comparable arguments on core competences and core rigidities, and alliance capabilities).

The abundant attention for the dysfunctions of formalization in recent literature has led some researchers to argue that 'the pervasiveness of the view that control is inherently negative has limited our ability to further explore how control may help solve [the] unique challenges of managing' (Cardinal, 2001: 31). However, our review of the literature on both the intra- and the interorganizational level discloses rationales that are commonly brought forward for instigating and for abstaining from formal processes and procedures. Table 6.1 provides an overview of the functions and dysfunctions of formalization, their elements, and several of the key references associated with them. In the remainder of this paragraph, we briefly discuss each of formalization's functions, including those that are advanced in the mainstream governance literature, such as coordination and control, and functions of formalization that are recognized less often, such as enabling cognition and learning, and obtaining legitimacy. Subsequently, we discuss formalization's dysfunctions.

Cognition & learning: formalization as a means to give and make sense

A first function of formalization involves cognition and learning, as formalization serves as a means to give and make sense (for more details, see also the previous chapter). This function refers to formalization's role in providing a set of stable and comprehensible expectations to participants in interorganizational relationships (see Cooray and Ratnatunga, 2001; Lindenberg, 2003; Shenkar and Zeira, 1992; Simonin, 1999). It concerns the fact that formalization adds clarity to their jobs (Podsakoff et al., 1986), affords them a collective structure from which to construct their actions (Weick and Roberts, 1993), and helps them to view each other's contributions in light of a greater scope and context (Organ and Greene, 1981). Formalization also reduces levels of ambiguity (Adler, 1993; Lui and Ngo, 2004; Shenkar and Zeira, 1992; Simonin, 1999), and acts as a binding mechanism, or focusing device (Nooteboom, 1992), holding events together in people's heads, and providing meaning and direction (see Bisbe and Otley, 2004; Camillus, 1975; Langley, 1988; Simons, 1990, 1995; Weick, 1995, 2001). It offers guidance during search activities (Bisbe and Otley, 2004), and fulfills the basic human needs for stability (Piore, 1995; Ring and Van de Ven, 1989), and role clarity (Marginson and Ogden, 2005). Specifically, by acting as a 'generic social technology for arresting, fixing, stabilizing and regularizing what would otherwise be a wild, amorphous, and hence unlivable world' (see Chia, 2002: 867) formalization offers a means to accomplish clear, orderly, and meaningful experiences (Marginson and Ogden, 2005). Achieving stability by means of formal governance mechanisms is therefore particularly important in the early stages of interorganizational cooperation (Fryxell et al., 2002; Larson, 1992).

TABLE 6.1
Overview of the functions and dysfunctions of formalization

Functions	References	Dysfunctions	References
<p>1. Cognition & learning: formalization as a means to give and make sense</p> <p>Accuracy expectations Degree of ambiguity Focusing attention Completeness and consistency Force people to reflect and think Governability of the relationship Anticipation and mind-stretching Target for contraction Induce collective learning Generation of new ideas</p>	<p>Cooray & Ratnatunga, 2001; Shenkar & Zeira, 1992 Lui & Ngo, 2004; Simonin, 1999; Weick, 1995, 2001 Delmar & Shane, 2003; Langley, 1988; Weick, 1995 Katz & Kahn, 1966; Ketokivi and Catañer, 2004 Sampson, 2003; Zollo & Singh, 2004 Clegg et al., 2002a; Rose & Miller, 1992 Camillus, 1975; Gomes-Casseres, 1996 Stinchcombe, 2001; Zollo & Singh, 2004 Avadikyan et al., 2001; Zollo & Singh, 2004 Langley, 1988; Simons, 1990, 1995</p>	<p>Inhibiting creativity, innovation, flexibility, and mutual accommodations</p> <p>Reducing commitment and aspirations, and limiting the scope for initiatives that fall beyond specifications</p>	<p>Ireland et al., 2002; Mintzberg, 1994; Volberda, 1998</p> <p>Balogun & Johnson, 2004; Gouldner, 1954; Jap & Ganesan, 2000; Hendry, 2002; Katz & Kahn, 1966</p>
<p>2. Coordination: formalization as a means to achieve concerted action</p> <p>Division of labor Common language/communication Signaling device Fuel interaction processes</p>	<p>Simon, 1997; March & Simon, 1958; Galbraith, 1973 Grimaldi and Torissi, 2001; Simons, 1990, 1995 Langley, 1988; Milewicz & Herbig, 1996 Mintzberg, 1994; Peattie, 1993; Simons, 1990, 1995</p>	<p>Extrinsic incentives drive out intrinsic motivation</p>	<p>Fehr & Falk, 2002; Kreps, 1997</p>
<p>3. Control: formalization as a means to exercise restraint or direct influence</p> <p>Control of the partner organization Control of deviation from objectives Control of progress / pace setting Control from a distance Option to forego control Trusting the partner</p>	<p>Masten, 1996; Oxley, 1997; Williamson, 1985 Delmar & Shane, 2003; Weick, 2001; Yavitz & Newman, 1982 Gouldner, 1954 Gouldner, 1954; Langley, 1988 Poppo & Zenger, 2002</p>	<p>Inducing the risk that areas of unilateral dependence and hold-up problems arise</p> <p>Involving high costs, incompleteness, as well as limited enforceability</p>	<p>Klein, 2000; Klein et al., 1978; Lusch & Brown, 1996; Macneil, 1980</p> <p>Masten, 1996; Williamson, 1985</p>
<p>4. Legitimacy: formalization as a means to persuade and convince stakeholders</p> <p>Internal legitimacy External legitimacy</p>	<p>Meyer & Rowan, 1977; Walsh & Dewar, 1987 Kale et al., 2001; Sitkin & Bies, 1993</p>	<p>Giving rise to data manipulation, organizational strife, and short-termism</p>	<p>Marginson & Ogden, 2005; Schweitzer et al., 2004</p>

Besides, formalization facilitates sensegiving and sensemaking by enhancing the completeness and consistency with which issues are covered (Camillus, 1975; Forrester, 1975; Mintzberg, 1994; Naur, 1982). It also reduces position biases (Ketokivi and Catañer, 2004), and cognitive biases or failures made by individuals (Katz and Kahn, 1966)²³. It might even force people to reflect and think²⁴. After all, formalization calls for cognitive efforts (Gouldner, 1954; Katz and Kahn, 1966), which might result in deeper insights about the potential causal factors underlying observed outcomes (Zollo and Singh, 2004), and which may render interorganizational relationships governable in the first place (Rose and Miller, 1992). With respect to learning, formalities instigate the maintenance of existing knowledge, incremental improvement of previous know-how, and the creation of totally new knowledge (Avadikyan, 2001). As formalities are more easily replaced than individually held or tacit assumptions and routines (Stinchcombe, 2001; see also Nelson and Winter, 1982), they may act as targets for contraction (Zollo and Singh, 2004). Furthermore, formalization is known to facilitate mind stretching and anticipation (Camillus, 1975; see Gomes-Casseres, 1996). It might provoke sharing and synthesizing of knowledge sets, implicit assumptions, and mental models on the part of participants in interorganizational relationships (Kotabe et al., 2003), possibly assisting in the creation of 'insights and ideas' for managing future alliance situations more effectively (Kale et al., 2001: 466). Formalization can thus yield a sense of discovery, and result in new ideas and strategies (Simons, 1990).

Coordination: a means to achieve concerted action

Formalization's role in ameliorating coordination is an issue that takes up several forms (March and Simon, 1958). Formalization allows for coordinated action by enabling the division of labor between partners, diminishing their interdependence (Singh, 1997). It helps to translate complex problems into 'terms that are clear and understandable' (Simon, 1997: 345), and it resolves issues of who does what,

²³ Ketokivi and Catañer (2004) found that strategic planning may attenuate position bias, consisting of managers' identification with sub goals. In addition, Katz and Kahn (1966) argue that formal procedures can be devised to counteract individual biases, arising from our tendency towards global and undifferentiated thinking, dichotomized thinking, cognitive nearsightedness, and oversimplified notions of causation. Besides, specific formal procedures have been developed in organizations to counter immediate pressures in problem-solving, and to ensure more penetrating analyses of problems, increased search for alternative courses of action, and more adequate assessments of the utility functions of such alternative courses (Katz and Kahn, 1966: 295).

²⁴ Many of the beneficial factors that contribute to the effectiveness of writing come about partially as a result of a heightened state of awareness (Brody and Park, 2004: 147). Brody and Park signal that a number of researchers have posited that using language to label experiences helps to structure experience. They further argue that 'writing induces a state of mindfulness and heightened awareness, rendering more explicit the implicit feelings and ideas that may have been previously avoided or unexpressed and making connections and associations between previously disconnected thoughts, feelings, and aspects of identity' (Brody and Park, 2004: 152).

allotting responsibility to the parties involved (Balogun and Johnson, 2004). Formalization also enables more efficient information processing (Galbraith, 1977). In addition, formalization provides a common language (Grimaldi and Torissi, 2001; Simons, 1990 1995), and it makes processes in organizations more transparent (Walgenbach, 2001). Grimaldi and Torissi (2001), for example, found that the need to communicate and exchange knowledge with external organizations experienced by the five software firms they investigated drove these firms to invest in formal codification. Formalization also enables participants in interorganizational relationships to transfer knowledge, and communicate their goals in situations where consensus on meaning might never develop (Balogun and Johnson, 2004).

In addition, formalization permits participants in interorganizational relationships to check on each other's perceptions. Besides, formalization is used to signal preferred outcomes and behavior, thereby bringing partners' expectations in accordance with each other and eliminating inefficiencies and misunderstandings (Milewicz and Herbig, 1996). Marginson and Ogden (2005), for example, notice that budgetary procedures have been used by some organizations to signal the importance of cost consciousness. Similarly, contractual provisions 'provide a means for one party to signal to the other the absence of undesirable attributes and presence of desirable attributes' (Hill, 2001a: 42). A more dynamic aspect of formalization's coordination function, which is also closely connected to the sensegiving and sensemaking function of formalization (see also theme two) concerns its role in fuelling interaction processes between participants in interorganizational relationships (Bisbe and Otley, 2004; Simons, 1990, 1995). Analogue to organizations (see Eccles and Nohria, 1992) interorganizational relationships in motion resemble ongoing flows of actions and words, which are punctuated by events such as strategy planning exercises, or budget meetings. Formal documents serve as common bases for discussion (Camillus, 1975), and open up issues for scrutiny by making them explicit and visible (Mintzberg, 1994; Peattie, 1993). Congruent with these remarks, the purpose of formalities is 'to provide a framework agreement within which on-going discussions and negotiations can facilitate' [...] adaptation and coordination (Lorenz, 1999: 313).

Control: a means to exercise restraint or direct influences

A third function of formalization has control as its common denominator. From a control perspective, formalities are necessary as interests of partners to an economic exchange rarely coincide entirely (Buskens et al., 2003a), and because partners might display opportunistic behavior (Williamson, 1985). Formalization's role in controlling a partner organization has been principally emphasized by transaction cost economists (c.f. Masten, 1996; Oxley, 1997; Williamson, 1985), and agency theorists (Eisenhardt, 1989b; Lassar and Kerr, 1996; Shane, 1996), who recognize that cooperating organizations can be confronted with conflicts of interest and information asymmetry. Control is not only emanating from formalization as an outcome, but it also results from the process of formalization. In particular, the process of negotiating and memorializing the parties' agreement, and monitoring compliance, serves to make forgetfulness, lying, or non-

compliance more costly. Asking a party the same or similar questions repeatedly, as occurs in the process of negotiation, makes forgetting or lying more costly; forgetting or lying many times is more difficult than doing so once (Hill, 2001a). Besides, when one asks different representatives of a partner the same questions during negotiation and contracting processes, this reduces the partner's opportunities for behaving opportunistically. Hill (2001a: 46) offers an example of acquisition agreements arguing that 'if the seller is forgetful or apt to conceal, the negotiating process makes being so more difficult, as different representatives of the seller are asked the same or similar questions repeatedly.'

Analogue to the control of a partner organization, formalization's explicit character enables control of deviation from objectives, providing employees with a framework in which to put feedback regarding each others progress (Delmar and Shane, 2003), and offering managers signals as to when intervention becomes necessary (Goold and Quinn, 1990). Similarly, it acts as a mechanism to control progress (Weick, 2001; Yavitz and Newman, 1982), and it sometimes permits control from a distance (Gouldner, 1954). Moreover, by installing formalities, management provides itself with a bargaining instrument; something which can be given up as well as given use (see Gouldner, 1954; Langley, 1988). Finally, formalization facilitates control by enabling trust building, as it assists in demonstrating one's competence and knowledge, and as it reduces uncertainty about one's motives for engaging in an interorganizational relationship (e.g. Mayer and Argyres, 2004 Poppo and Zenger, 2002; also see themes one and four).

Legitimacy: a means to persuade and convince stakeholders

A fourth function of formalization draws on the concept of legitimacy, stemming from institutional theory (Baum and Rowley, 2002). Although much of the literature on interorganizational relations assumes that collaborative relationships are unimpeded by wide institutional norms governing organizational behavior (Marchington and Vincent, 2004), institutional theory indicates that to gain acceptance and to obtain resources and commitment, legitimacy has to be conferred upon interorganizational relationships. Formalization frequently extends a relationship's legitimacy – here defined as being congruent with recognized principles or accepted rules and standards – as it guarantees that interorganizational behavior conforms to the expectations of stakeholders, reducing their uncertainty and increasing their willingness to contribute to the relationship. This is especially important when uncertain conditions prevent stakeholders from applying means-ends rationality (Zimmerman and Zeitz, 2002). From this perspective, interorganizational relationships in which formalities, such as letters of intent, contracts, or formal business plans are omitted, lack acceptable accounts of their activities, so that they become less worthy, meaningful, predictable, and trustworthy (Suchman, 1995). Meyer and Rowan (1977: 350) indicate that such relationships are vulnerable to claims that they are 'negligent, irrational, or unnecessary.' Conversely, managers of interorganizational relationships 'that incorporate societally legitimated rationalized elements in their formal structures maximize their legitimacy and increase their resources and survival capabilities' (Meyer and Rowan, 1977: 352). Meyer and Rowan's ideas

are central to institutional theory, in which organizational arrangements that “make sense” and that “play by the rules” are favored (Suchman, 1995: 603). Incorporating formal structures and processes simply raises the commitment of internal participants and external constituents to interorganizational relationships because partners have demonstrated that they are willing and able to conform to coercive and mimetic isomorphic institutional pressures (Kale et al., 2001; Sitkin and Bies, 1993; Walsh and Dewar, 1987). Similar to nascent organizations, interorganizational relationships have to be viewed as being legitimate in order to prosper, something that they might pursue by conforming to expectations of others regarding the writing of business plans and other formalities.

Creating legitimacy is of significant importance for interorganizational relationships, as they are regularly embedded in dynamic and discontinuous business environments, which entail high uncertainty and risks. These factors complicate assessments of the relationship by internal and external stakeholders trying to appreciate the logic underlying them. In such cases, ‘a system to educate and communicate with external stakeholders and gain their support and appreciation is critical,’ and formal structures and systems are imperative to build ‘support for alliances among key external stakeholders’ (Kale et al., 2001: 467-465). This is particularly because stakeholders frequently have little or no record of past performance on which to base their evaluations (Zimmerman and Zeitz, 2002). Due to this uncertainty, stakeholders often find it difficult to appreciate the logic underlying these relationships. In these situations, organizations face the daunting task of gaining acceptance (Suchman, 1995). In such cases, they can gain legitimacy through formalization (Zucker, 1988), as this provides ‘frames through which meaning is made, and social action constructed’ (Baum and Rowley, 2002: 12). In this way, it becomes easier for stakeholders to value cooperative endeavors on their merits. Such relationships “make sense”, and avoid being questioned by stakeholders. The procedures and other structures characterizing these relationships render them understandable and comprehensible (Suchman, 1995). In this respect, Miller et al. (2004: 210) contend that the importance of formal planning ‘lies as much in its latent function in creating a favorable disposition towards implementation as in its manifest function in detailing implementation activities.’

Long-run effects: formalization as a means to generate rents in the future

Participants in interorganizational relationships might sometimes not be able to pick these fruits of formalization directly. Some of the effects that have to do with sensegiving and sensemaking, coordination, control, or legitimacy only surface in the long run. This results from the fact that formalities can take on the character of an interorganizational memory (e.g. see De Boer et al., 1999), and become a repository for interorganizational learning (Mayer and Argyres, 2004). Contracts, for example, can function as memory traces of past negotiations (Putnam, 2003). Formalities store past experience ‘over more time, individuals, and situations’ than is possible in human memory (March, 1999: 4), thereby facilitating the leveraging of interorganizational expertise in other relationships (Kale et al., 2001), or in instances of intra-organizational cooperation. In cases where formalization

captures prior learning it can even enhance innovation (Cardinal, 2001). Associated with this, formalization reduces the dependence of interorganizational relationships on individuals. It diminishes the relative part of memory that is stored in human heads (Simon, 1997), making turnover of personnel less disastrous, and reducing relationships' vulnerability to fallible memories (see De Rond, 2003; Peattie, 1993; Simon, 1997)²⁵. In line with this, Ring and Van de Ven (1989: 184) notice that 'transactions of long duration require formal institutionalization, which permits a transaction to remain in force beyond the time span of the individuals who negotiated the transaction'. Evidence for this function of formalization is found by Dekker (2003: 100), who suggests that formal governance structures in interorganizational relationships serve to 'guarantee stability and continuity of the alliance in the future, in particular to cope with uncertainty about organizational, management and personnel changes.' In his study on three dyadic alliances in the Norwegian retail industry, Ness (2002: 29) even argued that: 'over time, contractual elements were more stable than the actual levels of trust' and that 'the hierarchical mechanisms defined a set of procedures [...] presented a sense of continuity and predictability in itself'. Finally, in the long-run formalization serves as a basis for replication and imitation, as formal structures and systems are highly visible, and entail a low degree of tacitness (Nelson and Winter, 1982; Simonin, 1999). This not only reduces the risk that things are "forgotten" (Mintzberg, 1994), but also enables capabilities and technologies to be transferred relatively easy across organizations (Lepak and Snell, 1999).

Dysfunctions of formalization

Attention regarding the dysfunctions of formalization has been abundant during the last few decades, possibly as a result of shifting perspectives on organizational entities from rational to natural and open systems (Scott, 2003), and heightened attendance of interorganizational researchers to issues of trust, social capital, flexibility, and relational capabilities. In particular, researchers have emphasized formalization's retarding effect on creativity and innovation, and its role in inhibiting flexibility needed for coping with complex, ambiguous and unstable task environments (Camillus, 1975; Mintzberg, 1994; Nooteboom, 1999; Volberda, 1998). Formalization has also been argued to lead to rigid forms of organization (Lampel and Shamsie, 2000; Volberda, 1998), as it stifles desirable mutual accommodations (Ireland et al., 2002)²⁶, and limits opportunities for adaptation (Nooteboom, 1999). Furthermore, formalities such as explicit contracts have been found to reduce partners' commitment to a relationship and to increase the extent to which conflicts arise between them (Jap and Ganesan, 2000). Formalization

²⁵ 'Because much of the memory of organizations is stored in human heads, and only a little of it in procedures put down on paper (or held in computer memories), turnover of personnel is a great enemy of long-term organizational memory' (Simon, 1997: 233).

²⁶ After all, changes in the environment and the relationship, coupled with the ambiguity and uncertainty created by tensions between cooperation and competition in interorganizational relationships suggests that optimal governance evolves across time and through partner interactions (Ireland et al., 2002; Cardinal et al., 2004).

entails the risk of reducing aspirations and performance to minimum standards (Gouldner, 1954; Katz and Kahn, 1966), limiting the scope for initiatives that fall beyond specifications in agreements (Hendry, 2002). Balogun and Johnson (2004: 532), for example, found that the introduction of contracts in cooperative endeavors sometimes made things worse, 'with individuals only doing exactly what was specified and nothing else.' Eventually, formalization may gradually degenerate into formalism (Balogun and Johnson, 2004; Mintzberg, 1994; Scott, 2003; Starbuck, 1983).

Besides, the extrinsic incentives incorporated in some formalities might lead to a reduction in intrinsic motivation by the cooperating partners (Fehr and Falk, 2002; Kreps, 1997). In addition, formalization entails the risk that areas of unilateral dependence (Lusch and Brown, 1996; Macneil, 1980) and hold-up problems arise (Klein, 2000; Klein et al., 1978). Moreover, the costs of writing contracts and other formalities, and their necessary incompleteness (Williamson, 1985), as well as their limited enforceability (Masten, 1996)²⁷ have led researchers to question formalization's efficacy. Finally, issues like data manipulation, interdepartmental and interorganizational strife, and short-termism (Marginson and Ogden, 2005) have challenged the advantageousness of formalization. Goals set in formal documents, for example, may give rise to unethical behavior, including the overstatement and false claiming of accomplishments, when parties are unable to reach these goals (Schweitzer et al., 2004).

6.4 Case study

Our exploration of the literature indicates that multiple functions and dysfunctions of formalization can be distinguished, and that they can be meaningfully categorized. The overview was not meant to be exhaustive, however. It serves as a basis for showing how alliance managers cope with the tensions resulting from the co-existence of formalization's functions and dysfunctions, as depicted in Figure 6.2. In the case study, we demonstrate that formalization's functions and dysfunction indeed co-exist, and that alliance managers find several ways to cope with the tensions emanating from their simultaneous occurrence.

Data Collection

In Textbox 6.1, we capture the most important characteristics of our data collection. From June 2002 to July 2004, twenty-two semi-structured interviews were conducted. Interview guides were developed (for details, see McCracken, 1988), which outlined the issues that were to be explored and which served as a checklist during the interviews. The majority of the interviews took place with participants from STEADY, as the lion's share of the ninety persons of both

²⁷ Contractual agreements are generally incomplete 'because of the inability to identify uncertain future conditions or because of the inability to characterize complex adaptations even when the contingencies themselves can be identified in advance' (Goetz and Scott, 1981: 2). Masten (1996: 10) suggests that courts are not the reliable enforcers of contractors' intentions as sometimes portrayed in both the law and economics literatures.

organizations that were involved in the relationship worked for STEADY. Interviewees included persons that were involved with the relationship for a significant period, from one up to more than five years. Of the interviews, all but one was tape-recorded and subsequently transcribed ad verbatim, resulting in 458 pages of interview text. Transcribed interviews were coded in QSR NUD*IST Vivo (for more details see Bazeley and Richards, 2000). We used the functions and dysfunctions described in the theory paragraph of this chapter to distinguish why formalization was applied, and which negative consequences resulted from its application. Attempts of managers to cope with the resulting tensions were coded under a category labeled “tensions” and observations on interorganizational performance were categorized under the heading “performance”. Beyond interviews, numerous archival data were collected, including 743 documents containing service level agreements, project handbooks, reports, memos, letters, web pages, annual reports, agendas, status reports and minutes from meetings. During data collection, we developed a database in which all documents stemming from the relationship were filed and categorized by author, date, and type.

TEXTBOX 6.1

Overview of key characteristics data collection

- Twenty-two semi-structured interviews held between June 2002 and July 2004. All interviews were tape-recorded and transcribed ad verbatim, resulting in 458 pages of interview text.
- Interviewees included:
 - Alliance manager (QUICK)
 - Commissioner on the business side/manager of the alliance (STEADY)
 - Two project leaders for central IT applications (STEADY)
 - Project leader for the overall IT project (STEADY)
 - Project leader for the IT infrastructure (STEADY)
 - Project leader for the shops (STEADY)
 - Project leader for the administrative organization (STEADY)
 - Analyst of customer relationships (STEADY)
 - Two process and system analysts (QUICK)
 - Two Service level managers (QUICK and STEADY)
 - Director shop-systems (STEADY)
 - In-company legal advisor (STEADY)
 - System maintenance manager (STEADY)
 - Customer service manager (QUICK)
- More than 700 documents were analyzed using QSR NUD*IST Vivo, including formal & change requests (13), evaluation reports (9), spreadsheets (74), memos and notes (8), minutes of meetings (178), service level agreements (18), conceptual-, functional, technical-, and test-designs (318), presentations (19), progress reports (24), interview transcripts (22), and others (82).

Congruent with descriptions of case study research by Strauss and Corbin (1998), we started our analysis of the data with preconceived notions on the functions and dysfunctions of formalization. We used open coding procedures to code each piece of text indicating a function or dysfunction of formalization into one of the categories that emerged from the theoretical overview. We labeled information regarding how the alliance's management coped with the duality surrounding the decision to apply formalities, and the tensions between the functions and dysfunctions of formalization emanating from it, under the categories "dualities" and "tension management". Subsequently, we applied axial coding to link similar concepts together into more abstract categories. In this step, respondents' remarks on focusing attention and reducing ambiguity, for example, coalesced into the category "cognition and learning". Finally, we followed selective coding procedures (see Strauss and Corbin, 1998) to relate the extent of formalization applied in the relationship to the categories used during open and axial coding. Descriptive and interpretive validity were secured through real-time data collection and prolonged engagement with the research site, tape-recording of the interviews, producing verbatim transcriptions, and performing accuracy checks with respondents. Besides, the reported findings were reviewed and commented on during a workshop and in individual feedback-meetings and they were continually cross-referenced with other data sources. Moreover, multiple sources of evidence enabled us to resolve possible inconsistencies in the answers of respondents, and it facilitated triangulation of evidence (Eisenhardt, 1989a; Strauss and Corbin, 1998; Yin, 1994).

Case Study Description

The description of the case study is structured as follows. We start with a general introduction, in which we explain the objective of the alliance, the way it was structured, and interorganizational performance as perceived by participants in the relationship. We consecutively describe the functions they attributed to formalization, the dysfunctions of formalization that surfaced, and the ways in which the alliance's management coped with the resulting duality and tensions.

The objective of the alliance between STEADY and QUICK was to deliver financial services in a retail environment, something which could radically change the financial services landscape in the country where the relationship was initiated. Potential services related to the provision of savings accounts, insurance packages, and financial services that would be integrated into the shopping process, like the refunding of packaging deposits, and saving by rounding off shopping payments upwardly. Complementarity between the partners' resources seemed high, with STEADY having a retail channel and a huge customer base, and QUICK possessing a banking-license, a back-office infrastructure for processing financial transactions, and legitimacy as a provider of financial services.

Negotiations on the alliance began in March 1999. The first round, which led to a contract-frame, took around six months, whereas filling in the complete contract took almost a year. Although the negotiations were constructive, the presence of

lawyers occasionally led to polarization. The in-company legal advisor of STEADY suggested that this was caused by the fact that lawyers are often paid by the hour and that they are accustomed to raise objections. The advisor argued that providing lawyers with an advisory role instead of a mandate to negotiate would have contributed to a smoother development of the negotiations. The in-company legal advisor of STEADY also mentioned that exhaustive discussions during negotiations were intended to diminish potential problems in the future.

'As far as I know, the contract has never been changed. Neither were there regular renegotiations. Of course, it is a matter of discussing things thoroughly. If you avoid speaking about certain issues, it will come up later anyway. That is only a temporary reprieve. It is better to bring everything up for discussion instead of thinking that you are able to polish it away in a later stage. Just put it on the table and discuss it. Then you avoid a lot of problems in the future' (Interview with in-company legal advisor STEADY, 30 January 2003).

Starting parallel to the negotiations, a business case was being developed by a small group of eight persons, four from each of the two organizations, which was finalized in about three months. Besides describing the possibilities for cooperation in general, the business case contained the outcomes of several major decisions. In particular, the scope of the alliance for the first few years to come was clearly defined. Choices were made as to which financial services would be provided to STEADY's customers, and what would be the possible follow-up services and projects after the launch of the first round of services. During the development of the business case, influence and involvement of the IT-department and the marketing-department of STEADY were kept to a minimum in order to accelerate the development of the alliance and to encourage innovativeness. This top-down strategy, accompanied by a high level of formalization, was deemed necessary by the alliance's management to facilitate creativity and flexibility on the one hand, while, on the other hand, making sure that the pace of development was rapid enough and that things were carried out in a rigorous and consistent way. The alliance managers of QUICK and STEADY justified the decision by stating:

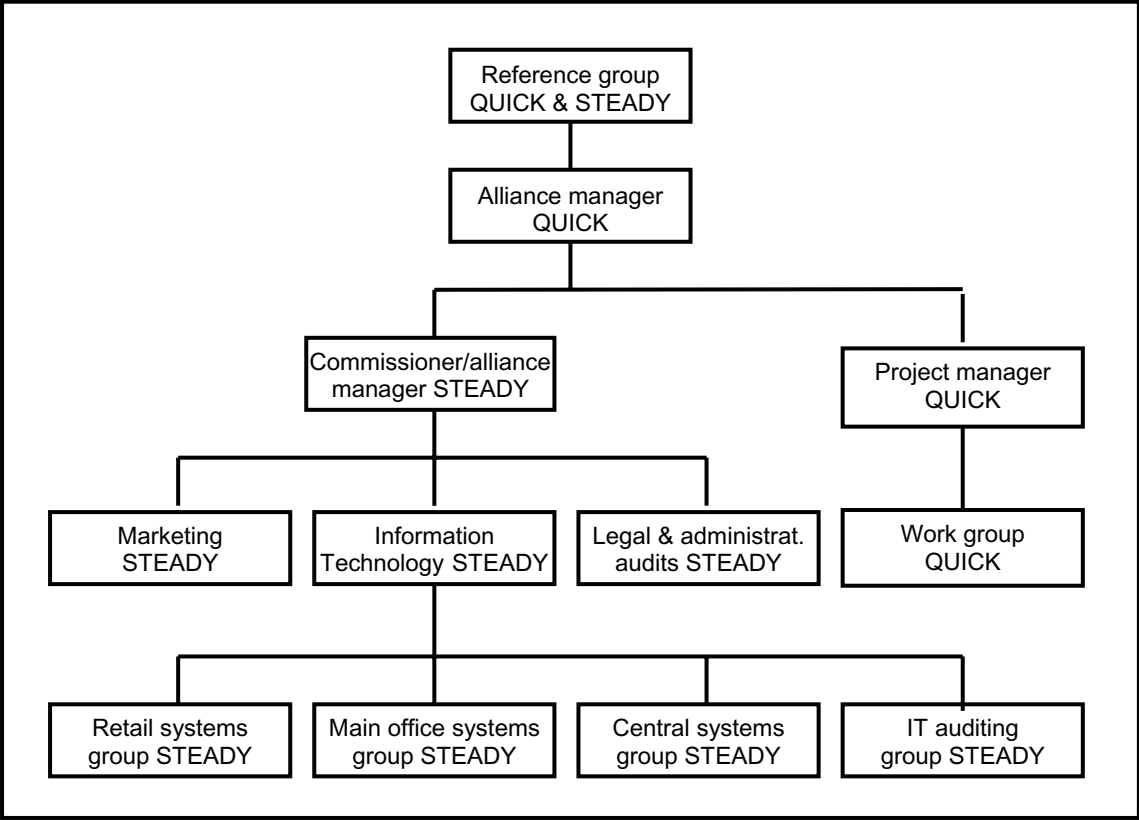
'It is my personal conviction that innovation cannot be achieved when everybody within a company is allowed to participate. Room needs to be created for innovation. If you get everybody involved, there are always persons there who need to sacrifice. They will try to slow down the cart and they will organize a lobby in order not to achieve something' (Interview with alliance manager QUICK, 28 January 2003).

'Formalization removes creativity and flexibility from a project. That is the downside. The upside is that it guaranteed that what we developed worked nearly faultlessly' (Interview with alliance manager QUICK, 28 January 2003).

'I think that to make sure a project proceeds at a certain pace, one has to be clear about the desired outcomes [...]. We had to formulate what we wanted and how the result should look. On the one hand, that infused speed in the project and largely simplified decision-making. On the other hand, it increased the risk taken by us as commissioners, because if things went wrong, it would clearly be our problem' (Interview with alliance manager STEADY, 6 January 2003).

After the business case was finalized, an interorganizational structure was designed for the alliance that would be used during the first major project, which took more than two years (see Figure 6.3). As can be seen from the chart, the alliance was backed up by a reference group consisting of senior managers from both STEADY and QUICK, which was used as a soundboard, and which offered advice and evaluated the relationship. The organization chart also reveals that the alliance included a strong IT-component. Operational activities that took place at STEADY were subdivided over six working groups, corresponding to existing departments within STEADY. At QUICK, fewer activities needed to be performed, and they were therefore concentrated within one working group.

FIGURE 6.3
Interorganizational structure of the QUICK-STEADY alliance



Relative autonomy between both companies and their operational groups was facilitated by the early definition of interorganizational interfaces. Although communication and coordination predominantly took place by means of formal documentation, weekly meetings in which managers of all working groups came

together guaranteed mutual adjustment. The interorganizational structure has not been formally revised over the course of the first project in the alliance, and new projects were organized according to similar structures. When no new activities were developed, the alliance managers, service level managers, and several other key stakeholders in the relationship met each other at least four times a year in pre-scheduled meetings, whereas most of the persons involved in the relationship had bilateral contacts with participants from the other organization every week.

During different stages of the alliance, both partners worked along formal lines, applying a standard methodology. The partners subsequently developed multiple versions of a business case, a conceptual design, impact analyses, functional designs, and functional detail designs and technical designs for the various project groups. The documentation from previous stages served as a basis for subsequent phases and compatibility of the documents from various stages was continuously monitored. Most activities had a very formal character, while the level of formalization grew progressively during the alliance, as can be derived from comments of the CRM-analyst and STEADY's alliance manager respectively.

'They [formal procedures] are handled strictly. So, also a functional design needs to be signed by everybody. And even if somebody comes with a dodge or a trick that requires adaptation, then these things need to be changed very formally, via change requests' (Interview with CRM-analyst, 18 November 2002).

'Of course it started rather vaguely, but it enters a funnel and becomes more and more formalized and structured' (Interview with alliance manager STEADY, 5 August 2002).

Participants from QUICK were not used to acting in such a formal way. However, QUICK's experience with the formal way of working of STEADY, combined with its desire to transform itself into a more customer-oriented organization, made it gradually adopt a more formal working style. QUICK's evolution towards an organization with a more formal character appeared to be a joint outcome of managerial intentionality and environmental effects, hinting at the co-evolution of partner organizations and interorganizational relationships (Koza and Lewin, 1998; Volberda and Lewin, 2003). Such effects became apparent from the comments of several interviewees from QUICK, including the customer service manager, and a process and systems analyst. These comments indicate that alliance level characteristics can elicit changes and developments at the organization level.

'Because I came from QUICK, I was working very ad hoc myself and paid little attention to recording things; just the things of which I thought that they were really important. Because of the alliance, I have started to record and describe everything. If anything is added, an instruction is made for it, or an education plan is being developed [...]. I have adopted many of the working practices of STEADY. I was not used to that way of working, but I adopted it' (Interview with customer service manager, 3 December 2002).

'And it has led to a little more formalization of things. Nowadays you will see that we have agreed on certain procedures, with which people have to comply. You see that the organization is maturing. The realization that that was necessary has risen during the alliance. STEADY has been the trigger for that' (Interview with process and systems analyst, 12 December 2002).

Consistent with previous work on interorganizational performance (Avadikyan, 2001; Sobrero and Roberts, 2001, 2002), both positive and negative aspects could be delineated. However, with only a few exceptions, the interorganizational performance that was attributed to the alliance was perceived to be high (for examples of comments, see Textbox 6.2). At the beginning of 2001, the first financial services were distributed through STEADY's shops. After one month, almost 100,000 customers made use of one or more of the financial services offered. At the outset of 2003, this number had almost tripled, leading STEADY's alliance manager to state that 'the introduction of financial services in a retail environment by these two partners was the most successful introduction of a new financial service in the last ten years' (Interview with alliance manager STEADY, 4 June 2002). In general, respondents regarded the introduction of financial services products as having positive performance implications for both organizations. They mainly pointed to ameliorated market positions, enhanced images of uniqueness and innovativeness, enhanced customer loyalty, and heightened efficiency of operations. The respondents also emphasized the difficulty of copying the alliance's business proposition by competitors, due to the unique resource combination, technologically sophisticated requirements, and long development times. Other respondents mentioned an absence of severe operational problems, and the usability of knowledge, experience, and deliverables for other interorganizational relationships. Furthermore, both organizations experienced some direct improvements in their processes, including the possibility to process transactions in parallel, and the introduction of permanent monitoring systems. Notwithstanding these positive evaluations, several respondents indicated that the initial expectations were not completely met. Besides, interviewees referred to the alliance's detrimental effect on the waiting times experienced by STEADY's customers at the cash register.

TEXTBOX 6.2

Exemplary comments on the alliance's performance

Efficiency: 'STEADY and QUICK are both very cost-conscious companies. So if you see how the project is put up [...]. The way in which we have knocked together this infrastructure is simply magnificent [...]. Other companies [names have been deleted] would have spend an amount of money that is probably tenfold as high' (Interview with alliance manager QUICK, 28 January 2003).

End-result: 'It is very positive that a system has been developed that is reasonably bug-proof. In other words, that everything has been gone through in a structured way and that with respect to IT-issues no or hardly any problems came up at STEADY' (Interview with CRM-analyst, 18 November 2002).

End-result: 'It resulted in a very stable, robust, reliable environment, that does what is should do. I am quite happy about that. And you also see that when considering disturbances' (Interview with overall IT project-manager, 6 January 2003).

Creating an image of uniqueness and innovativeness: 'I think that has contributed to STEADY's image of renewal. It has shown once again that it is an innovative company that can create an innovative product within a short period of time' (Interview with overall IT project-manager, 6 January 2003).

TEXTBOX 6.2

Exemplary comments on the alliance's performance (*continued*)

Enhancing customer loyalty: 'Of course it also fits within the strategy of one-stop-shopping, in which you provide a total package and the client does not need to go to other firms. The client does everything in one hand. He can save, shop, and withdraw money. On the basis of that strategy it fits perfectly well' (Interview with service-level manager STEADY, 11 November 2002).

Improving efficiency: 'A positive point is that we now have the possibility to enhance the efficiency of processes related to the loyalty program of STEADY. They become cheaper, and faster' (Interview with service-level manager QUICK, 8 November 2002).

Difficulty to imitate: 'This product cannot be copied. If you take a bag of potatoes, and you make a good price, then that is easily copied by a competitor. This is much more difficult to copy' (Interview with CRM-analyst, 18 November 2002).

Possibility of sequel products: 'What also makes it interesting is that sequel products could be introduced in a short period of time, that enable you to create additional turnover and margin on few square meters' (Interview with overall IT project-manager, 6 January 2003).

Expectations not completely met: 'The market is more difficult. Interest rates have come down to a level at which saving is not regarded to be attractive. Our competitive position has become worse, because of the high interest rates of our competitors [...]. That influences the flow of new customers' (Interview with alliance manager STEADY, 6 February 2004).

Loss of productivity: 'With the current means that we have at the cash register, it means that we encounter some productivity losses' (Interview with director of shop-systems STEADY, 28 November 2002).

Loss of productivity: 'I expect that the alliance has reduced the efficiency of the operation in the shops. I have to say that as a consumer I also think *ah, shit!*' (Interview with in-company legal advisor STEADY, 30 January 2003).

Project-management: 'In terms of project management the final result can be called a success, because it suffices the demanded functionality and specifications. We have produced what was requested' (Interview with system maintenance manager, 11 November 2002).

Experience spin-off: 'The knowledge and experience that we have built up to do this enable us to do similar projects faster and cheaper in future [...]. I think we have learned a lot from this alliance' (Interview with overall IT project-manager, 6 January 2003).

Data-encryption spin-off: 'The knowledge that has been built up with respect to data encryption is now possibly deployed again. We are working on a new project in which that also plays a role' (Interview with system maintenance manager, 11 November 2002).

Calibration of business cases spin-off: 'we have acknowledged that there are a couple of things which require more attention and better organization. Calibration of business cases for instance... I am convinced that if the alliance would not have taken place, other projects might have been started that were doomed to fail. So that is a spin-off of not-effectuated investments or costs that would not lead to successes' (Interview with CRM-analyst, 18 November 2002).

In the proceeding paragraphs, it will become clear that the relatively high level of formalization applied in the alliance influenced interorganizational performance through various functions and dysfunctions. Moreover, it indicates that the alliance's management faced a duality when deciding on the most appropriate level of formalization. After the level of formalization was decided on, dialectic tensions arose, which were potentially harmful to interorganizational performance. However, the alliance's management eventually capitalized on these tensions, thereby enhancing interorganizational performance.

Functions of formalization

In this paragraph, we consecutively address each of formalization's functions that have been distinguished in the literature review and in Table 6.1, starting with cognition and learning. Where the literature study suggested that formalization might help to clarify partners' expectations and understandings, evidence from the case study indicates that limited levels of formalization can have opposite results. Comparatively low levels of formalization applied by QUICK at the beginning of the relationship were found to raise uncertainty and ambiguity, as witnessed by a comment from a process and system analyst from QUICK.

'I can imagine that participants from STEADY sometimes thought: I hope that this will turn out all right. It [QUICK] seems a bit of an unguided missile that has started working there. If you do not get feedback, at least nothing on paper, or less than expected, or different from what you expect... I can quite well understand that that is scary' (Interview with process and systems analyst, 12 December 2002).

During the negotiations, different versions of legal documents, including contracts and other formal accounts, forced participants from both organizations to make sense of the alliance and the collaborative environment. It thereby reduced the likelihood that discordant implicit assumptions surfaced when it was too late. Initial versions of legal documents gave rise to discussions between the partners, laid bare potential conflicts, and tempered extreme confidence in the potential of the alliance (for a similar argument, see Sampson, 2003). This is illustrated by comments from the project leader for central IT applications, a system maintenance manager, a process and systems analyst, and the in-company legal counselor.

'At the moment you make your plan, you try to limit uncertainties. You describe the things that you do not know for certain, possibly with alternative directions for solutions [...]. If you do not do that, you can be certain that the final product will not become what everybody expects' (Interview with project leader central applications, 21 November 2002).

'Your own understanding of what is there only improves' (Interview with system maintenance manager, 11 November 2002).

'The conceptual design was probably more for me than what was written on paper...' (Interview with process and systems analyst, 12 December 2002).

'By putting it on paper you pave the way for good cooperation. It enables you to estimate what issues you will be confronted with and how these need to be resolved. Furthermore, it makes clear what you expect from each other. I think many people do not realize that. They dislike contracts. In the business-departments they think like this: We only use the contracts when things go wrong [...]. But they do not realize that it is just very important to make sure that nothing will go wrong' (Interview with in-company legal advisor STEADY, 30 January 2003).

A remark from STEADY's project leader on the infrastructure side hinted at the supportive role of formalization in enabling contraction.

'Before this project, little bits were described, but in a free-format. We were working on developing a standard, which was not finished yet. Many independent documents have been produced there, which have led us to state: That should be included for subsequent projects!' (Interview with project-leader infrastructure, 15 November 2002).

In addition, formalization appeared to ensure that the specifications for the IT-system that had to be developed were consummate, accurate, and consistent. This finding emanated from a discussion with STEADY's alliance manager on the functions and dysfunctions attached to applying high levels of formalization.

'The good side is that they [formal documents and procedures] kept us sharp with respect to the accuracy and completeness of the specifications' (Interview with alliance manager STEADY, 6 February 2004).

Besides, formal processes appeared to fuel the interaction processes between participants in the relationship. According to the project leader of the administrative organization and the project leader of infrastructure at STEADY, formalities functioned as simultaneously enabling and constraining structures within which agents interacted, triggering debate among participants in the relationship.

'During the process, it worked as a red line from one meeting to another meeting: to measure progress, to provide a kind of glue, and to communicate to others within the meetings. In my opinion, it is just for the process: keeping everybody on one line. And also to inform people and to record what should happen during the project and in the long term.' (Interview with project leader administrative organization, 21 November 2002).

'The formal documentation helped us to gradually come to decision-making. Like: We all agree about that point, we all sign for it, so we proceed again! When you are in a continuation trajectory, you make things and change things, for which you have to fall back on the things that you have done before [...]. If you do not do that in such a complex whole, you will lose the overview completely. And I think the project will then deteriorate into complete chaos' (Interview with project leader infrastructure, 15 November 2002).

Formalization's second function, coordination, appeared from its role in enabling a fine-grained division of labor between the partners in the alliance. Formalization entailed codification, in the form of documents. These documents subsequently served as a basis for the different workgroups in the relationship and as input for new rounds of socialization. Comments from the commissioner on the business side and the project leader for central applications are illustrative.

'The people from the business-department can start to work on the business aspects [...]. That happens parallel to each other. At the moment we finish the functional detailed design, people from the business-side also know exactly how it is going to work' (Interview with business commissioner STEADY, 5 August 2002).

'After you have made a functional design, it is sent to both the builders and the testers. The testers define their test cases while at the same time the builders are building the applications' (Interview with project leader central applications, 21 November 2002).

Related to enabling the division of labor, formalization reduced the perceived complexity of activities in the relationship, resulting from the fact that individual participants needed to 'solve' smaller parts of the 'problem' in the alliance. This effect of formalization became evident from the response of STEADY's project leader of IT infrastructures when he was asked whether he regarded the alliance to be complex or not.

'Complex? No, not really. Because the structure was well devised, it actually was not as complex as it seemed. The structure was really good' (Interview with project leader infrastructures, 15 November 2002).

Besides, formalized documents enabled decoupling of learning from action. This can be illustrated with an observation of the author when arriving early for an interview, taking a seat in a room with four employees of STEADY. One of the employees in the room was new to the alliance. He was busy studying formal documents. After a while, he asked '*is the maintenance of system X performed by QUICK?*' One of the other employees replied: '*No, you can see that from the scheme hanging on the wall. Besides, it is described in document Y.*' By studying formal documents that were developed during the alliance, the new employee was able to learn about it without actively having taken part in it.

The third function, formalization as a means to control, appeared in the form of monitoring progress and preventing frequent stretching of the scope of the alliance. This became evident from quotes by the overall IT project manager, and QUICK's and STEADY's service level managers. It appears that by freezing requirements and design at early stages, adverse effects of goal changes are avoided (Dvir and Lechler, 2004). Moreover, the project leader of retail systems indicated that higher levels of formalization by participants from QUICK at the beginning of the relationship would have increased the level of trust between both

organizations, as STEADY would then have been able to base its evaluation of QUICK on credible and more extensive information.

'It [formalization] has helped the IT-department to finish things. To say: Ok, this is it. Signed and all. In particular, that formal side has helped, because you are working on so many things at the same time. It was very handy to have some documents of which you can say: that's finished!' (Interview with overall IT project-manager, 6 January 2003).

'One has to prevent looking backwards by making a list of decisions made. One has to look forward by means of an action list. If you keep those sharp, things proceed' (Interview with service-level manager QUICK, 8 November 2002).

'It is very important that you ensure that agreements and decisions made on designs are recorded. That you do not find yourself in the situation that things are brought up for discussion afterwards, including things that are decided earlier on. [...]. If you do not document things well, then every decision causes a new discussion. If you document things, and you have commitment, and you confirm together that you are holding on to the same thing, then you have the same starting point for the next stage' (Interview with service-level manager STEADY, 11 November 2002).

'The status [progress] was verbally communicated, but was not supported by documents that were put on the table, from which it became evident that that was really the status. That would have helped. There would have been less distrust then. It was easy to say: we are now at this stage, and in two weeks things are finished' (Interview with project leader retail systems, 15 December 2002).

Formalization also seemed to function as a means to extend the internal and external legitimacy of the relationship and the activities undertaken in it. In the alliance, the mere existence of formalities legitimized rule observation, as became clear from a comment from STEADY's project leader of central applications. Besides, the detailed documentation that emerged from formal processes helped in legitimizing the relationship towards governmental bodies, as became evident from a comment of a service level manager.

'In the project plan everybody's tasks and responsibilities were described. Besides, we have an organizational chart. In that sense, you can find the responsibilities in the organizational chart. Authority for making decisions lay along exactly the same lines. That was reasonably clear' (Interview with project leader central applications, 21 November 2002).

'I suspect that the detailed documentation has helped to win institution X over. We said *Listen, have a look at how precisely we deal with these things*. I think that has helped' (Interview with service-level manager STEADY, 11 November 2002).

Finally, formalization proved to have several effects in the long-run. Amongst others, it functioned as a memory device, which became obvious from answers by QUICK's service level manager, STEADY's service level manager, and one of the

process and system analysts at QUICK on a question as to their reasons for using formal documentation.

'My experience is that if you do not produce action lists, lots of things disappear. Because (a) persons forget things, and (b) after a week you might remember that you need to do something, but you possibly have a different interpretation of the task than at the moment at which the issue originated [...]. It is simply a good way to keep people sharp' (Interview with service-level manager QUICK, 8 November 2002).

'The documentation warrants knowledge preservation, which is electronically accessible and on which, in a following project, people can build on. So your knowledge is preserved. Because people leave... you name it... Those are not stable factors' (Interview with service-level manager STEADY, 11 November 2002).

'It is very handy that some things are documented, especially because different persons become involved in the trajectory. Because we can agree verbally in a very precise manner, but if you are replaced by someone else, we have to start from scratch again' (Interview with process and systems analyst, 12 December 2002).

Related to formalization's use as an interorganizational memory, it reduced the vulnerability of the alliance. Formalization diminished the potential instability of the relationship caused by personnel changes, and temporary absence of people due to illness or holidays. The retail side project leader summarized it as follows:

'I think you should be able to agree on producing a certain amount of documentation, if it was only for the sake of taking away a little bit of the vulnerability of the organization. That not all knowledge resides in the head of one person, as that is what will happen' (Interview with project-leader retail, 28 November 2002).

In addition, formalities served as a basis for replication and imitation, witnessing the comments of a system maintenance manager and the retail project leader:

'There are advantages [of having formal documents] for new projects. We are now busy with a new project in which identical control-mechanisms from system A-B will be deployed. That is really easy. What happens, and how it is done is well described. It is just a matter of replication and adaptation to the new situation...' (Interview with system maintenance manager, 11 November 2002).

'It is easier for our new project [name omitted], because you know what is there. You know that everything has always been well-documented, so you can proceed from that easily' (Interview with project-leader retail, 28 November 2002).

Many of the functions of formalization were also attributed to visualization. Respondents more than once indicated that they preferred visualization or formalization by image, to formalization in words. Perhaps this results from the fact that visual aids have a greater capacity for fostering sense making. Properly

visualized data equip users with pre-processed models of the data enabling higher levels of interaction than if they had to make sense of the data in raw form (Sedig et al., 2003).

Dysfunctions of formalization

From the case study, several dysfunctions of formalization also became evident. First, participants in the relationship, in particular from STEADY, tried to cover themselves against risks emanating from the relationship, by formalizing working procedures in detail. This resulted in stiffened and rigid relations between its IT-departments and the business department, as is manifested in quotes from the business commissioner for the alliance at STEADY and a process and systems analyst at QUICK.

'When there was a hitch in the cable, at STEADY people sometimes tried to keep their own alley clean [...]. At QUICK we say: Some things go wrong and you have to solve them, but that can happen. Whereas I had the impression that they thought: They cut your head off, if something goes wrong. I have to make sure that it is not my fault' (Interview with process and systems analyst, 12 December 2002).

'Employees from STEADY keep their own alley clean. They are very precise. That becomes obvious when one considers the fact that they record everything in the minutes. One can also read between the lines in the progress-reports. They put problems aside, on the plates of others. Moreover, they connect problems to choices that have been previously made by others [...]. They also have a standard list with the risks of the project, from which you can percolate exactly how they try to cover themselves' (Interview with alliance manager STEADY, 6 January 2003).

A second adverse effect of formalization was the administrative burden it brought along. Eventually, this almost changed formalization from a means to formalization as an end in itself. Comments from the overall IT project manager and the CRM manager are illustrative.

'The vision is lacking with respect to why something is formalized. It has to be done like this because somebody says that it should be done like this' (Interview with overall IT-manager, 6 January 2003).

'One saw tension at STEADY, where behavior was very formal. They did not give any space to think about something when it had been previously defined. Exaggerating it a bit, it was as follows: Why do you do it like this? We do it like this because it is like this on paper. Not because it is best, but it is written on paper. Therefore, we do it like this' (Interview with CRM-analyst, 18 November 2002).

Management of dialectic tensions

The alliance managers attempted to cope with these tensions in three ways. First, the alliance managers alternately emphasized the disparate levels of formalization required by each of the parent organizations. Although it is a more or less accepted belief that dissimilar levels of formalization at parent organizations have negative effects on performance (e.g. see Lane and Lubatkin, 1998; Medcof,

1997), in this particular alliance, managers used the differences between both organizations to propagate speed in certain areas and stages, and to enhance control in others. When QUICK was not working thoroughly and accurately enough, STEADY's performance standards and codification requirements were stressed. In situations in which participants from STEADY were moving too slowly, they were confronted with the fact that their progress was far behind that of QUICK's employees. At those times, the alliance managers underscored the lower needs for formalization by QUICK, including the fact that QUICK was a smaller organization, which had to make only minor adaptations to its existing infrastructure and processes for the alliance. In sum, the alliance managers used the differences between both organizations to increase speed in certain areas and stages, and to enhance control in others. When one of the alliance managers was asked to comment on how he coped with the different levels of formalization within the partner organizations and the tension between the functions and dysfunctions inextricably bound up with formalization he stated:

'I think that the dissimilarity between the two firms eventually ensured that the project became a success. They were used to a completely different way of working. There was much more entrepreneurial spirit within the blood of the persons involved from QUICK compared to participants from STEADY. On the other hand, persons from STEADY had a much stronger instigation to have everything documented, reported, and crystallized out, up to the final detail, compared to participants from QUICK. And this is what happened: at points in time that persons from QUICK relied too much on writing on the back of a cigar-box for their software development, they were called to order by persons from STEADY. On the other hand, when things started to become too bureaucratic again with STEADY, persons from QUICK started to say: this is nonsense! You can also arrange it in this way. That gave rise to the entrepreneurial spirit again. We sometimes have, consciously or unconsciously played the characteristics of the two parties off against each other. I certainly did it myself, as I had to take care of QUICK living up to its promises. I regularly went to people from QUICK to say: *Guys, it's all okay what you are doing, but I want to have it on paper, because I cannot go to STEADY with this piece of paper. If you do that here, that is all right with me, but this is an external party, so the standard needs to be raised.* If we needed something done, we could use QUICK to convey strength and speed towards STEADY, whereas STEADY was more of a controlling and auditing master that checked whether things were ok' (Interview with alliance manager QUICK, 28 January 2003).

This finding resonates with arguments on the co-evolution of partner organizations (see Koza and Lewin, 1998; Volberda and Lewin, 2003) in that both the need and the ability to formalize – determined by transaction, organization, or contextual characteristics and attributes – and managerial intentionality, represented by alliance managers striving to maintain productive tensions between sets of functions and dysfunctions – played a role. It seems that managerial intentionality reduces the likelihood that vicious circles are formed (see also Volberda, 1998). Furthermore, we propose that managers' recognition of the dangers inherent in extreme positions on the formalization continuum, combined with their intention to utilize tensions resulting from intermediary positions prolifically, amplifies the positive influence of formalization on interorganizational performance.

The second manner by which the alliance managers coped with the tensions between functions and dysfunctions of formalization concerned their explanations offered to participants in interorganizational relationships for the level of formalization applied. As the selected level of formalization has consequences for participants in interorganizational relationships, it demands some explanation (see Shaw et al., 2003; Sitkin and Bies, 1993). In the case study, explanations given by the alliance managers for the high level of formalization adopted frequently referred to factors that were beyond their control. Demands imposed on the alliance managers by their own supervisors, for example, were regularly put forward during meetings with the project leaders. Besides, the alliance managers, on more than one occasion, underlined the fact that financial institutions like QUICK had to comply with the demands of regulatory institutions, which demanded the application of high levels of formalization. Finally, they suggested that any 'mistakes' would have an enormous impact on the reputation and image of the collaborating organizations. The alliance's management thus attempted to persuade and convince participants in the alliance to work along formal lines by accentuating external constraints imposed on the alliance instead of underlining their preferences for little interference of pressure groups, or their desire to have all departments work according to plans that were devised by themselves. The following comments hint in this direction:

'Before any money is spent, the board wants to know in broad lines what the plan is and what the financial consequences are. Ideally, they also want to be able to shoot three out of four plans' (Interview with alliance manager STEADY, 6 January 2003).

'We have a stick behind the door, because we are a bank now. So, many things cannot be discussed anymore, but simply have to happen' (Interview with alliance manager STEADY, 6 January 2003).

'To guarantee acceptance of the "external institutions" at the end of the trajectory, we had to be the "best-behaving boy of the class". That implied that I wanted to see many juridical obligations being carried through in the strictest form' (Interview with alliance manager QUICK, 28 January 2003).

'For the entire project, we had to obtain the accreditation of an external institution. That was a reason for us to say: we do it like this! That was one of the reasons to say: you do not need to take the responsibility for this project; we'll take it!' (Interview with alliance manager STEADY, 6 January 2003).

'Everyone realized that nothing should go wrong. We could not afford to lose money which was put on a savings account... That has to happen once or twice and you are on the front-page of a national newspaper and you have a serious problem' (Interview with alliance manager QUICK, 28 January 2003).

Alliance managers' use of this management tactic reveals that factors such as accountability, the importance of image, and legitimacy do not only augment the need for formalization, but also serve as a pretext by which managers of interorganizational relationships are able to institute higher levels of formalization

than would otherwise be accepted by other participants in the relationship. Under the guise of demands from supervisory boards, reference groups, or external institutions, and by intermittently adducing the magnitude of image risks, the alliance managers were able to maintain high levels of formalization. By using these arguments, they forestalled the development of insurmountable tensions. This finding complements results from earlier studies on justification and persuasion as influence tactics in mergers (Steensma and Milligen, 2003). It also coincides with observations that, amongst others, auditing systems are easier to implement and meeting less resistance when justified externally than when only motivated by a desire to improve supervision (Walgenbach, 2001). In summary, it reveals that managers attempt to convince and justify their decisions towards other participants in a relationship by focusing on factors that are largely beyond their control, thereby (partly) masking their true reasons for applying high levels of formalization²⁸.

Finally, the alliance's management tried to reduce the tension arising from the application of high levels of formalization by developing a kind of semi-structure. Semi-structures are frameworks in which some features are prescribed or determined (e.g. responsibilities, project priorities, time intervals between projects), but other aspects are not (Brown and Eisenhardt, 1997). Meyer and Rowan (1977), who remarked that hospitals and schools had highly specific and rigid rules of administration, while the professionals working in them sometimes had a high degree of freedom in how they approached their work, already gave an example of semi-structures. This kind of semi-structure is akin to the deployment of "simple rules". In such a situation 'outside the roles and responsibilities that the rules define, the individual remains free and autonomous' (Piore, 1995: 113)²⁹. Such an approach was also found in the present case, where clear rules helped people to see what they could and should do for the relationship. More general, definitions of the business, customers and goals renders people with arenas for action but leaves the specific means up to the various teams, thus enabling an

²⁸ One of the "true" reasons that is likely to play a role here has also been advanced by Gouldner (1954), in his case study of a Gypsum and mining company. He suggests that managers might be unsure of themselves and need something to lean on. After they are on the job somewhat longer, "they're less worried about the rules". He suggests that the rules define the new situation into which they enter, allowing them to make decisions with a minimum of uncertainty and personal responsibility. Gouldner adds that there is reason to believe that rules have a guilt-relieving role. He quotes the new manager of the factory who says "Some of the men probably think I'm a mean cuss, but I've got to follow our company policy like everyone else. If I don't, someone else will" (Gouldner, 1954: 94, 95).

²⁹ This coincides with observations on flexibility within structure from Tatikonda and Rosenthal (2000: 418), who conclude that: 'balancing firmness and flexibility, by having flexibility within a structure, is both achievable and desirable'. However, it has to be noted that this appearance of formalities has a disadvantage in that 'broad applicability comes at the costs of low explicitness'. The wider a clause or rule, the more space there is for different interpretations and the lower the enforceability (Blumberg, 2001: 828).

open, improvised and energized flow of innovative activities (Dougherty and Takacs, 2004: 579). Analogue, syndicates in the venture capital industry apply investment agreements that enshrine the rights and obligations of participants, rather than specifying behavior (Wright and Lockett, 2003). The managers of this particular alliance combined a high level of formalization of inputs and outputs with considerable process autonomy. This was done in order to economize on the efforts that management had to put into coordinating and controlling activities, while it also warranted the experience of sufficiently high levels of achievement and fulfillment by participants in interorganizational relationships when performing their jobs. Whereas the objectives, goals and expected outcomes of the alliance were recorded and enforced strictly, employees were often granted considerable latitude in how they accomplished those objectives. This resonates with the distinction made between the formalization of outcomes and the formalization of processes, or the distinction between behavior control and output control from Ouchi (1979), and Ouchi and Maguire (1975). The commissioner on the business side at STEADY revealed why they chose to deploy high outcome but low process formalization.

'I believe that you have to make sure that the broad outlines and the detailed explanations are provided, so that everyone can solve his part of the puzzle. Everybody knows what the input-variables and the output-variables are, and they only have to shape the piece of process in between. If you have them participate in thinking out the project, you have to invite them all around the table. That is difficult to coordinate and to govern as it involves multiple levels, highly specialized employees, people who use the opportunity to stress their distinctive features, and departmental politics' (Interview with alliance manager STEADY, 6 January 2003).

'The role that one chooses as a commissioner is either having them do their work as they wish it themselves, with their own control and consultation structures, and planning-cycles. In that case, you only provide input as to what you want them to realize [outcome formalization]. Or you also stand as a kind of project manager, prescribing how they have to work [process formalization]. I have not done the latter, because you will not succeed in doing this with two persons. So we had them use their own working and planning methods, while providing them with input, telling them how we wanted the output to look [...]. If you provide them with limited freedom concerning what they should do, then you should not also interfere with how they do that, with how they are going to structure that process. That will take away all the fun they have in managing such a project' (Interview with alliance manager STEADY, 6 January 2003).

This finding conflicts with assertions of Koza and Lewin (1998: 260) that 'Ceteris paribus, the greater the exploitation intent of an alliance, the greater the reliance on output control,' and 'ceteris paribus, the greater the exploration intent of an alliance, the greater the reliance on behavior and process controls.' Our findings indicate that exploration alliances – the alliance studied here is clearly a case in which innovation is of the utmost importance – are not necessarily dominated by behavior and process controls. Instead, as contingencies are hard to identify in advance, and because this type of relationships requires mutual adaptation over time (Madhok and Tallman, 1998), such relationships involve designs for action, in

which outcomes, accountability for outcomes, and constraint/restraint boundaries are demarcated (Haeckel, 2004). Control of behavior is frequently inappropriate in these relationships as it takes away the ability of individuals to exercise their judgment (Goold and Quinn, 1990), potentially lessening personnel motivation and limiting job scope, eventually resulting in boredom, alienation, job dissatisfaction, absenteeism, turnover, and reduced output (Nygaard and Dahlstrom, 2002).

6.5 Discussion

We started this chapter by asking how our view on the role of formalization in interorganizational relationships would change if more attention was paid to managerial choice. We embraced the idea that dialectic tensions arising from the co-existence of positive and negative consequences – or functions and dysfunctions – of formalization cannot always be solved (Ring and Van de Ven, 1989), but instead have to be managed (Huxham and Beech, 2003). We thus drew theorizing away from perspectives in which contextual, organization, or transaction characteristics determine the degree of formalization and towards a perspective in which the role of managerial choice is emphasized (Child, 1997). Such a perspective aims to elucidate how managers cope with the tensions between the functions and dysfunctions associated with formalization (see Das and Teng, 2000; De Rond, 2003; De Rond and Bouchiki, 2004). In line with this, we formulated the following research question:

RQ7: How do managers of interorganizational relationships cope with tensions arising from the co-existence of formalization's functions and dysfunctions?

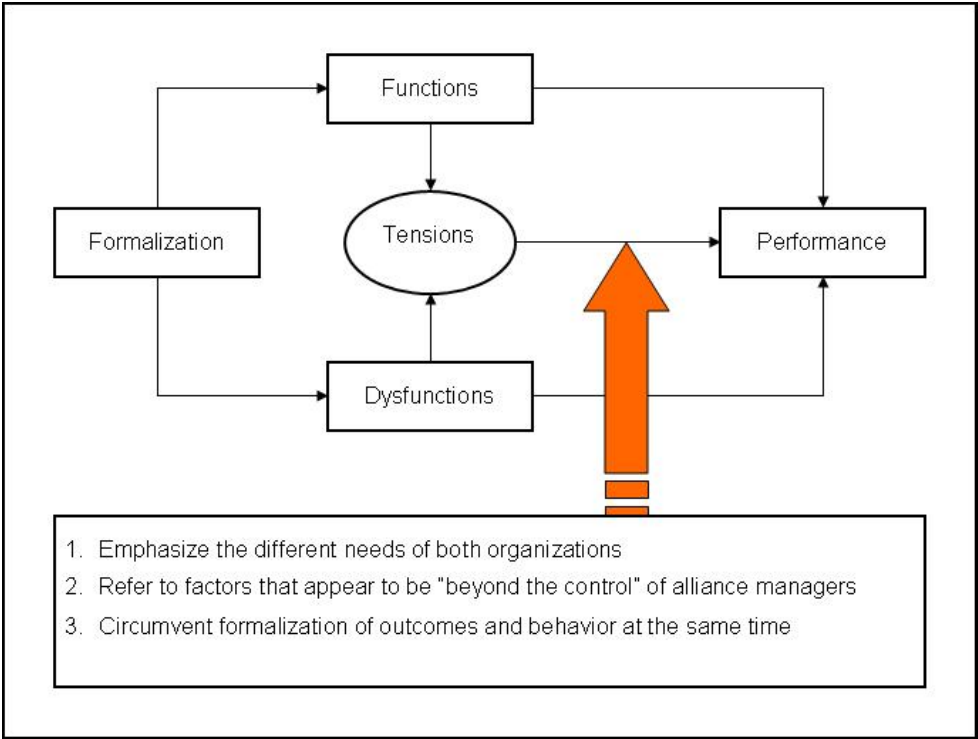
Key findings

We demonstrated that formalization functions as a means to coordinate and control, but also as a means to persuade and convince stakeholders, and as a means to give and make sense (see also theme two). Moreover, we described a number of dysfunctions associated with formalization, such as its retarding effect on creativity and innovation, and its role in inhibiting flexibility needed for coping with complex, ambiguous and unstable task environments (Camillus, 1975; Mintzberg, 1994; Nootboom, 1999; Volberda, 1998). The case study showed that dialectic tensions between the functions and dysfunctions of formalization were inevitable. A high level of formalization became almost imperative as the number of employees involved in the alliance was high, and external institutions, such as regulatory agencies, were closely watching the movements of the partners. Furthermore, the relationships concerned financial services, which engender high image risks in case things go wrong. In addition, the issues to be tackled contained many interdependencies, entailing high demands for coordination and control. Finally, as the relationship involved many novel elements for both parties, cognition and learning through formalization played an important role.

At the same time, however, several dysfunctions emerged. We showed that alliance managers attempted to cope with the resulting tensions between the functions and dysfunctions of formalization in at least three ways (see Figure 6.4).

First, they alternated their emphasis on the disparate levels of formalization required by each of the partner firms. Second, they justified the level of formalization that had been applied by referring to factors that appeared to be beyond their control. Third, they applied a kind of semi-structure, emphasizing either the formalization of outcomes or the formalization of processes. These findings illustrate that introducing a dialectic perspective on formalization in interorganizational relationships offers a promising complement to existing perspectives. Most importantly, a dialectic perspective elucidates that manager are not only preoccupied with taking the “right” governance decisions (Foss and Foss, 2005; Madhok, 2002; Williamson, 1985, 1991), but also, and perhaps primarily, with managing the tensions emanating from these decisions.

FIGURE 6.4
Three ways of coping with tensions arising from formalization



Theoretical and practical implications

The theoretical implications of this inquiry pertain to the design of studies on interorganizational structures and structuring practices. The large variety of functions and dysfunctions of formalization described in this chapter indicates that mono-causal explanations of interorganizational structuring efforts are unlikely to

render consummate and accurate pictures of interorganizational reality. We therefore suggest that inquiries into the role of formalization in interorganizational relationships could benefit from explicitly measuring the motivations, causes, or reasons for (not) applying contracts, rules and procedures, something that could lead to a more refined image of the drivers of formalization. Such an image could explain why formalization is still 'endemic in modern societies' (Meyer and Rowan, 1977: 343), and it could complement 'traditional understandings of organizational structure' that are currently breaking down (Hatch, 1999: 75).

Our research also has several practical ramifications. Managers who are aware of the numerous functions and dysfunctions through which formalization influences interorganizational performance should be able to strike a balance between formal and non-formal approaches towards alliance management. They are in a better position to recognize the tensions emanating from formalization, and to ameliorate interorganizational performance by finding ways to cope with these tensions. These managers do not choose between "control" or "autonomy". They are able to hold and explore opposing views (Eisenhardt, 2000) on the (dis)advantageousness of formalization and they appreciate the fact that formalization has a broad range of functions and dysfunctions. This enables them to counteract the tendency to over-rationalize and it helps them to apply formalization in a beneficial way.

Limitations and opportunities for future research

Although we believe that the chapter has yielded several interesting findings, it also contained some major limitations. First, our data did not permit us to compare our findings with the results that we would have obtained when a more generic model of formalization would have been used to analyze the case (e.g. antecedents influencing formalization, which subsequently influences interorganizational performance). Although coordination and control perspectives on the role of formalization in interorganizational relationships neither cover the wide range of functions and dysfunctions of formalization, nor the managerial aspects that are so significant in a dialectic approach, future studies might investigate different perspectives on formalization side by side. Analogue to Baum and Rowley (2002) and Madhok (2002), we urge researchers to use multiple theoretical lenses for investigating the role of organizational structuring processes. We advance that theoretical explanations for observed levels of formalization in interorganizational relationships, which solely focus on its 'coordination' and 'control' functions, underestimate effects that are less obvious and probably less frequently anticipated. The functions discerned in our literature review further denote that interorganizational management research might have to pay more attention to the process of formalization, and to the voluntaristic, subjective, and dynamic qualities of structuring processes (Barley, 1986). The traditional preoccupation with formalization's outcomes (Zollo and Singh, 2004), in the form of contracts, rules and procedures, could be complemented with a stronger focus on functions related to the process of formalization.

Second, we observed that alliance managers' formalization decisions were preceded by incomplete considerations of the entire array of functions and dysfunctions that occurred in the case study. Each of the interviewed alliance managers only mentioned a few of the functions and dysfunctions of formalization that were discerned based on our literature review (see Table 6.1). In particular, little reference was made to (sub)functions of formalization that seem harder to anticipate, such as 'forcing people to reflect and think,' and to (sub)functions that influence performance in more remote futures, such as the use of formalities as an 'interorganizational memory.' This suggests that managers apply simplified decision-making processes (March and Simon, 1958; Simon, 1997) when deciding on the level of formalization to be applied in their relationships. This underscores the significance of managerial attention during interorganizational governance processes (see also theme four), and indicates that research might benefit from "bringing the manager back" in interorganizational governance research.

Third, the relationship between formalization and performance that is sometimes proposed in the literature, in the shape of an inverted u-curve (Luo 2002), appears to be a strong simplification of interorganizational reality. In particular, this relationship seems to be moderated by alliance managers' abilities to cope with dialectic tensions emanating from the level of formalization actually applied (see Figure 6.4). By conducting additional case studies, the external validity that can be attributed to this finding could be enlarged. More general, compelling support from other cases could support the further development of a dialectic view on the role of formalization in interorganizational relationships.

7 THEME 4 – CONTRACT STANDARDIZATION

‘Social psychology is replete with theories that take for granted the “fact” that people think [...]. They all start with the assumption that people attend to their world and derive behavioral strategies based on current information.’

Langer, Blank and Chanowitz, 1978: 635

‘Mindlessness often overshadows human thought when it comes to actual decision making.’

Sharps and Martin, 2002: 272

Summary

The application of standard contracts and standard procedures for negotiating and contracting is omnipresent in interorganizational transactions. However, only few studies on interorganizational governance actually consider how standardization influences interorganizational relationships. In this chapter, we present an overview of the benefits and drawbacks of contract standardization. A review of the literature indicates that standardization enables an efficient and expeditious effectuation of transactions. Moreover, standard contracts are considered relatively legitimate, robust and easy to interpret compared to tailor-made contracts. However, they also tend to be very non-specific. Probably even more significant is that the application of standard contracts is frequently preceded by negotiation and contracting procedures that hardly contribute to the creation of shared expectations. Standardization is therefore argued to prohibit the “meeting of minds” and to encourage “mindlessness” during negotiation and contracting practices. This assertion is assessed empirically in an analysis of contracting practices in 911 buyer-supplier relationships. Structural equation modeling reveals that the use of standard procedures for negotiation and contracting generally diminishes parties’ attention to the substantive details of a transaction, and that it reduces the impact of contracting on interorganizational performance. These findings imply that academics can draw more accurate descriptions of negotiation and contracting practices if they consider standardization in their research, and they urge practitioners to be cautious with contract standardization.

7.1 Introduction

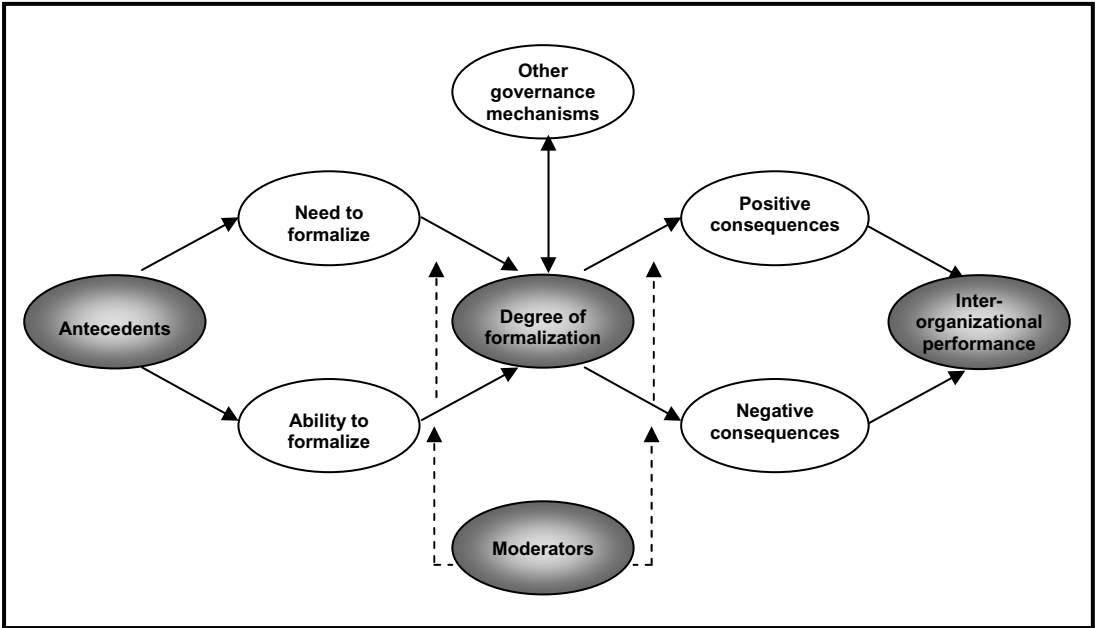
Most research on contracting in interorganizational relationships appears to presume that actors are (boundedly) rational, and that they act self-interestedly, suggesting that they devise contractual structures that minimize transaction costs (Williamson, 1985) and that maximize the value that can be created from transactions (Foss and Foss, 2005). These assumptions imply that more complex and more risky transactions are governed by more complete and highly specified contracts (Williamson, 1985). In practice, this frequently appears not to be the case (Eggleston et al., 2000). In this chapter, we offer an explanation for this observation by challenging the idea that contracting always occurs mindfully. We

do not contest that cooperating parties match firm-level and transaction- or relational level factors with governance structures, but we do indicate that the standardization of negotiation and contracting processes prohibits interorganizational participants from devising optimal governance structures. In constructing our argument, we capitalize on the observations from Langer et al. (1978) and Sharps and Martin (2002), indicating that we should not take for granted the idea that people always behave “mindfully”. In line with this, we advance that contract standardization reduces the likelihood that parties achieve a “meeting of minds”, one of the most fundamental functions attributed to negotiation and contracting processes (Gluck, 1979; Goetz and Scott, 1985). Furthermore, we contend that standardization of negotiation and contracting reduces mindful or encourages mindless behavior by interorganizational participants.

As contract standardization is omnipresent in practice, but receives only scant attention in the literature (Korobkin, 2003), we do not solely underpin these assertions here, but we commence by investigating the advantages and disadvantages of using standard contracts more generally. Accordingly, we divide the chapter into two parts. In part one, we review the literature on standard contracts and we develop an overview of arguments for and against their use in interorganizational relationships. In part two, we shift the focus from standard contracts to standardization as an attribute of negotiating and contracting practices. Here, we advance that standard procedures for negotiation and contracting involve lower degrees of mindfulness than the formulation of tailor-made contracts. In other words, we posit that participants in interorganizational relationships will act less carefully, critically, purposefully, attentively, and conscientiously (Ryle, 1949; Weick and Roberts, 1993) when adopting standardized procedures to define their exchanges and to coordinate and control their relationships, possibly harming interorganizational performance. The extension of generic contracting models in the literature with a factor capturing the degree to which negotiation and contracting practices are standardized relates to the areas that have been shaded in the research framework depicted in Figure 7.1 and it is further specified in Figure 7.2.

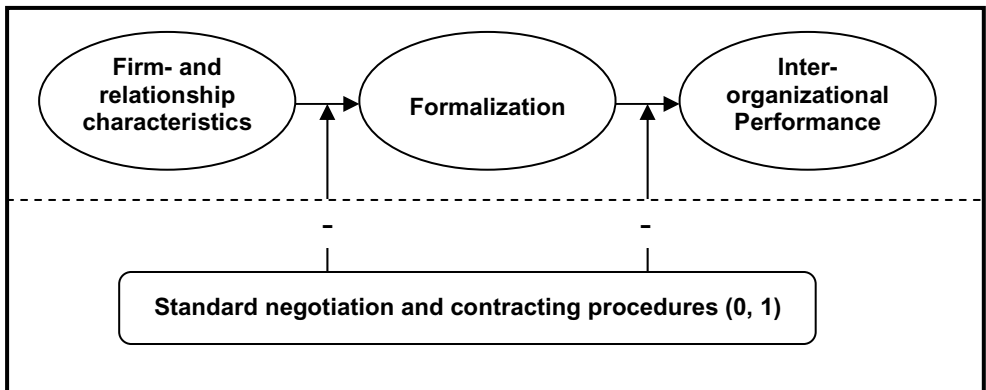
The chapter’s main contribution is to illustrate that research on standardization, which currently pertains to various areas, including global environmental policies by multinationals (Christmann, 2004), work programs for building projects (Blyth et al., 2004), quality systems (Walgenbach, 2001), and international marketing programs (Zou and Cavusgil, 2002), has to be extended to negotiation and contracting practices in interorganizational relationships. In the chapter, we take some initial steps in this direction, by offering an overview of factors that contribute to the rising significance of contract standardization, and by noticing that there are several downsides to contract standardization that are easily overlooked. Our findings caution practitioners of neglecting the downsides of standardization, and it encourages them to consider whether and when mindlessness ambushes in their transactions, and how it can be prevented or mitigated.

FIGURE 7.1
Research framework – theme four



The chapter is structured accordingly. In the following paragraphs, we discuss the advantages and disadvantages associated with contract standardization. Subsequently, we deploy structural equation modeling to assess whether the use of standard procedures for negotiating and contracting diminishes the magnitude of the relationships between firm-level and transaction or relational level factors, formalization, and interorganizational performance on a sample of 911 buyer-supplier relationships. In the discussion, we elaborate on the implications of our findings and on issues that could be addressed in future research.

FIGURE 7.2
Generic research model extended with standardization



7.2 Part I: advantages and disadvantages of standard contracts

We start developing our argument by leveraging the observation that standard contracts – here defined as the application of similar contracts or contract terms in a range of contractual transactions – have gained wide currency (Korobkin, 2003). This was evident already in a study by Macaulay (1963: 58), in which lawyers complained that businessmen ‘desire to keep it simple and avoid red tape even when large amounts of money and significant risks are involved.’ However, this has not been translated into a well-developed scientific knowledge base, witnessing the ‘relative silence’ in the law, contracts, and management literature regarding the reasons for and the implications of contract standardization (Kahan and Klausner, 1997: 715). Hitherto, it is unclear, for example, what reasons firms have for deploying or opting out of standard contracts, and what their effects are on interorganizational cooperation (Kahan and Klausner, 1996; Korobkin, 2003).

To investigate these questions, we have to look for the origins of contract standardization (see Textbox 7.1). The phenomenon first emerged at the end of the nineteenth century. In that period, industrial firms aiming at mass-production became more or less forced to use preprinted, standardized contracts, primarily for efficiency reasons (Gluck, 1979). Since then, contracts have frequently been formulated in line with certain standards, corresponding to conventional patterns (Young, 1998). Large enterprises started to apply comparable contracts in relationships with different clients and suppliers (Eggleston et al., 2000; Macaulay, 1963), thereby utilizing knowledge gained in one transaction for managing other transactions (Johnson et al., 2004). These contracts contained terms that were incorporated irrespective of the characteristics of the transaction or the collaborative context (Epstein, 1999). Branch organizations, law and accountancy firms and the legislative power also promoted the development and application of such terms (Hill and King, 2004). As firms have been committing themselves to a steadily proliferating number of interorganizational relationships, a certain degree of standardization has now become imperative, rendering the application of relatively simple standard contracts the rule rather than the exception (Eggleston et al., 2000). The main factors contributing to the rise of standard contracts and some major drawbacks of contract standardization are listed in Table 7.1.

TEXTBOX 7.1 Facts on the standardization of contracts

Origin:	End of the nineteenth century. Result of mass-production
Sources:	Prior relationships of the own firm with similar or other partners, legislature, branch organizations, law and accountancy firms.
Necessary due to:	A growing number of interorganizational relationships.
Current trend:	Application of contract management software.

Source: Gluck (1979) and upsidesoft.com

Inherent efficiency of standard contracts

The motive most commonly advanced for the application of standard contracts and standard contract terms derives from the idea that this type of contract is inherently optimal (Kahan and Klausner, 1996). The presupposition here is that the substance of standard contract terms optimizes the value of a transaction, irrespective of the deployment of the same contract clause by other parties, and regardless of its application by parties in prior transactions. Proponents of this argument suggest that quasi-Darwinian competitive processes eventuate in a situation in which clauses that have appeared efficient before are being reused, whereas inferior clauses are abandoned and disappear from the scene (Klausner, 1995). Standard contracts then only entail the relatively low costs connected to the mechanical task of formulating and filling out the forms and they can be replicated almost without costs in other transactions (Kahan and Klausner, 1997). They are associated with exploitation, routinization, systematic cost and complexity reductions, and increased efficiency (Sussman, 1999). Because the duplication of efforts is circumvented and as the collective experience from earlier transactions is fully utilized, the application of standard contract terms entails advantages of scale, scope and experience (Klausner, 1995). The development of complex contracts, instead, is costly and often becomes complicated due to bounded rationality of contracting parties (Goetz and Scott, 1985).

TABLE 7.1

Overview of the advantages and disadvantages of contract standardization

Advantages	References
Efficiency of the transaction	Gluck (1979); Kahan & Klausner (1996)
Transaction speed and robustness	Epstein (1999); Goetz & Scott (1985)
Exploitation of information asymmetry & Prevention of unintended signaling	Eggleston et al. (2000); Korobkin (2000); Hill & King (2004)
Legitimacy granted to a contract	Hill & King (2004); Kahan & Klausner (1996, 1997)
Unequivocal contract interpretation	Goetz & Scott (1985); Pietroforte (1997)
Network-effects	Klausner (1995); Korobkin (1998)
Disadvantages	References
Low level of contractual specificity	Goetz & Scott (1985); Kahan & Klausner (1996, 1997); Korobkin (2003)
Limited potential for developing mutual expectations and joint understandings	Gluck (1979); Hill (2001); Ring & Rands (1989); Ring & Van de Ven (1989)*

* Most of these references indicate that non-standardized, intensive negotiation and contracting procedures enable sensemaking and are conducive to the “meeting of minds”.

Pace and robustness of transactions

A second advantage of standard contracts is that they can be effectuated quickly (Epstein, 1999; Salbu, 1997). Standardization results in comparatively short negotiation cycles, and it allows firms to efficiently exchange with multiple partners, because it 'reduces search, monitoring, and enforcement' efforts (Schilling and Steensma, 2001: 1155). Due to standardization, firms can increase the pace with which they come to 'understand and evaluate potential deals, something which ultimately enables them to respond more quickly to potential opportunities and threats in their environment (Salbu, 1997). Savings in time are often just as critical as the relatively low costs associated with standardization, because parties may experience high competitive pressures during relationship formation processes, or because partners have the desire to introduce new products on the market before competitors do so (Klausner, 1995). The significance of timesaving benefits is manifest in a remark of Norman Goldfarb, the CEO of First Clinical Research, a medical institute in San Francisco. He notes that 'reducing contract negotiation means we can get life-saving drugs to the market quicker [...]. When you figure that every day of delay in approving a drug costs a drug company an average of \$1.3 million, if we save two weeks, we're talking serious money' (eyeforpharma.com). Standardized contract terms are also generally robust, and of a high quality. After all, earlier formulations 'bring to bear a collective wisdom and experience that parties are unable to generate individually' (Goetz and Scott, 1985: 286), and they are only accepted in the business community after they have been exposed to deliberation and reflection (Epstein, 1999; Hill, 2001b). As a result, standardized contracts generally exist of time-tested and relatively "safe" provisions that minimize the risk of unintended effects (Goetz and Scott, 1985), insulate parties from significant downside risks, and reduce the chance that things are forgotten during negotiations (Hill, 2001b).

Ability to utilize information-asymmetry and prevent unintended signaling

Another advantage of standard contracts is that they enable parties in interorganizational transactions to maintain beneficial information-asymmetries. Although a partner that has more information at its disposal is generally better equipped to write detailed contracts, it might not be in its best interest to do so. Consequently, an important rationale for applying standard contracts is that the best-informed party only has to concede a limited amount of information to the other party. This can be highly desirable, as revealing information might enable another party to take advantage of the focal organization. Standard contracts thus offer parties the opportunity to withhold strategic information (Eggleston et al., 2000). Moreover, standard contracts signal trustworthiness, and they decrease the risk that parties "upset" each other. Instead, when writing tailor-made contracts the possibility of some bad event may be raised, possibly damaging the relationship, even if the event never occurs, and even if the party had not reacted in the way that it describes. In this case, the acceptance of contractual incompleteness by transaction parties offers a positive signal, fostering cooperation, and preventing a "contractual arms-race" from developing between the partners (Hill and King, 2004). Instead, when contracts and the contracting processes preceding them are considered 'inscrutably complex, mysterious or ambiguous', they will tend to deter

engagement and confidence, reducing a potential partner's comfort with and confidence in a focal firm (Salbu, 1997: 374).

Enhancing the legitimacy of transactions

Transaction partners and other stakeholders in interorganizational relationships, such as investors, banks, clients, and suppliers are generally familiar with standard contract terms (Kahan and Klausner, 1996, 1997). This familiarity generally yields them with 'increased comfort with and confidence in decision assessments' regarding prospective transactions (Salbu, 1997: 373). Standard contracts have proven to be valid in earlier transactions and their meaning is frequently clearer and less susceptible to differences in interpretation than tailor-made contracts. Moreover, they are regularly developed by firms with solid reputations, such as investment companies and law offices (Klausner, 1995). Stakeholders are therefore inclined to believe that standard provisions are necessarily the most suitable for interorganizational transactions. These factors add to the perceived legitimacy of transactions (see Meyer and Rowan, 1977). In particular, standard provisions are surrounded by 'an aura of stability and objectivity' (Kahan and Klausner, 1996: 363). Consequently, organizations feel the "obligation" to apply standard contract terms, irrespective of their efficiency. In this sense, the institutionalization of standard contracts results from pressures caused by organizations that have already adopted them, resulting in a form of isomorphic behavior (Fiol and O'Connor, 2003). We make the annotation here that the legitimacy of standard contracts is dependent on the institutional environment in which a transaction is embedded. Whereas a lawyer in Germany comes across aggressively if he or she proposes detailed tailor-made contracts, a lawyer in the United States is reproached for lacking inspiration and competence in case contract provisions are not intensively negotiated. This difference may stem from the fact that Germany is less marked by a history of adversarial industrial relations (Lorenz, 1999). It is probably also due to the smaller size of the German trade community and the more prominent role of branch organizations compared to the United States (Hill and King, 2004).

Enabling unequivocal contract interpretation

Explicitly formulated tailor-made contract terms are also often more liable to differences in interpretation than standard contracts. Tailored contracts compound costs and uncertainty related to litigation as directly applicable precedents are lacking (Hill, 2001a). Standard provisions, instead, are less likely to contain ambiguous language and inconsistencies. They have a more consistent meaning (Goetz and Scott, 1985; Salbu, 1997), and they are easier to interpret because jurisprudence is available and judgments have already been passed about these provisions (Kahan and Klausner, 1996, 1997). In the United States, for example, the most frequently used contract for the design and construction of buildings is made available by the American Institute of Architects (AIA). The primary function of these contracts, according to Pietroforte (1997), exists in the acknowledgement of generally accepted stages, responsibilities and roles, which results in a predictable environment and a common understanding regarding the context of interorganizational transactions and the meaning that parties attach to issues

included in the contract. In particular, the relative certainty that contract parties derive from the use of previously applied standard provisions increases the attractiveness of this type of contracts (Goetz and Scott, 1985). After all, standard provisions reduce ambiguity, and, consequently, the interpretative burden with which stakeholders are confronted and the risk that inconsistent interpretations arise (Epstein, 1999; Hill and King, 2004). This is not only helpful during litigation, but also reduces the likelihood that parties bring a case to court. It holds both for organizations active in civil law countries as well as for organizations that have to adhere to common law. In civil law, legislation is seen as the primary source of law. Courts thus base their judgments on the provisions of codes and statutes, from which solutions in particular cases are to be derived and they have to reason extensively on the basis of general principles, or by drawing analogies from statutory provisions to fill lacunae. By contrast, in the common law system, cases are the primary source of law, while statutes are only seen as incursions into the common law and thus interpreted narrowly (www.wikipedia.org). In both cases, standardization can diminish the quivocality surrounding contract interpretation. However, in civil law cases, the standard will be derived more directly from the law, whereas in common law cases standards are frequently based on prior deals.

Reinforcement of advantages by network effects

The rationales for adopting standard contracts that have been listed here are amplified by the existence of network advantages. Network advantages imply that increasing returns to the utilization of standard contracts arise in case more organizations deploy such contracts (Klausner, 1995; Kahan and Klausner, 1997). In case an ever-growing group of organizations adopts certain contracts, many of the advantages of standard provisions that have been discussed previously are reinforced. Standard contracts can be applied, for instance, in a larger number of transactions, while the costs of legal advice are lower, and the pace with which deals can be concluded becomes even higher. The same accounts for the availability of jurisprudence, and for the ease with which the meaning of specific contract provisions for potential partners can be determined.

Low level of contractual specificity

Despite the many rationales that one may advance for applying standard contracts, standard contracts also have several drawbacks. The most obvious drawback of standard contracts is that they are likely to be sub-optimal, because a contract provision that was efficient for the situation in which it came into existence is not necessarily equally suitable for other transactions (Sussman, 1999). Standard provisions might be sub-optimal from the beginning, or organizations might simply adopt standardized provisions in situations in which alternative contracts are more efficient (Kahan and Klausner, 1996). The development of standards is highly sensitive to starting conditions or history-specific components (Cohen and Bacdayan, 1994). If in the first instance a standard contract, for example, is developed for a transaction between organization A and B, it is likely to look different from a first initiative to developing a standard contract engrafted on a transaction between organization A and C. This coincidental character of the origins of a standard contract undermines the claim that prevailing practices will

converge to an efficient solution for commercial problems (Epstein, 1999). Furthermore, as standards necessarily have to apply to a range of exchanges, they are less likely to do justice to the particularities of individual exchanges. In other words, standard contracts frequently do not effectively capture context and task characteristics. Their content further tend to diverge from the needs of contract parties (Pietroforte, 1997), as adaptations of standards frequently lag behind changes in the contexts and conditions with which parties to exchanges are being confronted (Goetz and Scott, 1985). Standard contracts thus entail the risk of thoughtless or perfunctory application. In a sense, this involves the inappropriate generalization of prior experience towards novel situations (Hoang and Rothaermel, 2005). Freund, who describes a mock merger between Suggestive Software Ltd. and Proliferating Products Inc, offers an example. He quotes a supervisor lambasting a junior associate in a law firm for having done a rotten job in his first draft of an agreement, resulting from the “default” application of contract terms. *‘Merry Christmas, Pete. Now look fella, you’ll just have to forgive my candor, but time’s short and this draft of the Proliferating-Suggestive agreement is an inferior job. The problem is that you just didn’t think. You walked out of here, you went into the library, you grabbed that Screwloose binder off the shelf, you had a photocopy made of the final contract, and you marked it up for the purposes of this draft.’* (Freund, 1975: 500, in Hill, 2001b). The example illustrates that the adoption of standard contracts frequently lacks thorough analysis (Kahan and Klausner, 1997), and that it locks parties in conventional modes of thought (Young, 1998). This reduces the inclination to consider context and task characteristics that are peculiar to a transaction when writing contracts.

Limited potential for achieving a “Meeting of Minds”

A second significant shortcoming of standard contracts is that they are not being preceded by a process in which mutual understanding between transaction partners is created, and in which expectations are being set. The rise of standard contracts has thereby destroyed one of the main functions of the negotiation and contracting process, being the possibility for transaction parties to discover what they want from a transaction and from each other (Hill, 2001a) and reaching mutual understanding (Ariño and Ring, 2004). Gluck (1979: 74) expresses this as follows: ‘The important thing to be realized is that, with the development of the standard form, the contractual document has drastically changed. While the traditional bargained out document was in itself evidence of the understanding, the same cannot be said of the standard form document...’ Standard contracts destroy the bargaining process (Gluck, 1979), as they reduce communication about the contents of a promise, right, or obligation, calling into question the reliability of such contracts (Goetz and Scott, 1985). Where non-standardized formal negotiation and contracting processes enable or even enforce parties to give meaning and make sense of interorganizational relationships and their underlying logics (Ariño and Ring, 2004; Ring and Van de Ven, 1994), the utilization of standard contracts inhibits these processes. Although pure contract theoreticians presuppose that all contract provisions are being negotiated and read, standard contracts are frequently not read (Eisenberg, 1995; Korobkin, 2003), and they do not involve fierce negotiations. Consequently, sensemaking is

hampered and the development of mutual understandings and shared expectations becomes more difficult. This is particularly problematic when ambiguity exists between partners, or when relationships do not closely resemble market transactions, so that a meeting of minds entails more than reaching agreement on product specifications and price.

7.3 Part II: how contract standardization may lead to mindlessness

Now that we have furnished an inventory of the advantages and disadvantages of standard contracts, we shift our attention towards the standardization of the negotiation and contracting procedures leading up to these contracts. We investigate how the standardization of these procedures influences interorganizational cooperation. Merriam Webster's dictionary provides us with a useful starting point for investigating this question (www.m-w.com). According to the dictionary, a procedure comprises a series of steps followed in a regular definite order, and it involves a traditional or established way of doing things. Standardization applies when procedures are uniform, well established by usage, and widely recognized as acceptable. It attests to a certain "fixedness" or homogeneity within external exchanges (Brown and Timmins, 1981). Standard procedures then consist of established methods that are followed routinely. They comprise a form of abstracted and explicit representation of collective routines (Cohen and Bacdayan, 1994), which are created and refined over multiple cycles of exchange (Subramani and Venkatraman, 2003). Such standard procedures are frequently rather inertial and relatively invariant to signals and feedback that could call for their revision, so that little variety is present among negotiating and contracting practices for different exchange relationships³⁰. Contracting parties may come to respond to the world in a limited and rigid fashion (see also Luchins, 1942), overlooking simpler or better solutions to similar problems.

It appears that the application of standard procedures for negotiating and contracting involves relatively low degrees of mindfulness. In order to develop this argument further, we explain the concept of mindfulness. Mind is a dispositional term that denotes a propensity to act in a certain manner or style (Weick and Roberts, 1993). It ranges from stupid to intelligent (Ryle, 1949). Mindfulness refers to active and fluid information processing, sensitivity to context and multiple perspectives, and the ability to draw novel distinctions (Langer, 1989). It implies 'noticing, taking care, attending, applying one's mind, concentrating [...], alertness, interest, intentness, studying, and trying' (Ryle, 1949: 136). It is associated with

³⁰ Findings from previous investigations show that standardization of procedures is closely related to formalization of the same procedures (Mansfield, 1973). In the National Study, for example, Child (1972) found a correlation of .87, whereas in the Aston studies Pugh et al. (1969) found a correlation of .83 between both constructs. In our inquiry, however, standardization is regarded as an attribute of the negotiation and contracting process (see Lillrank, 2003), a process that can be more or less standardized. This is supported by the insignificant value for the correlation between formalization and standardization for our sample of buyer-supplier relationships (Kendall's tau-b = .022, $p < .429$, $n = 899$).

actively drawing distinctions and making meaning, and it involves great sensitivity to one's environment, openness to new information, the creation of new categories for structuring perception, and awareness of multiple perspectives (Langer, 1989; Langer and Moldoveanu, 2000). Mindlessness, instead, involves relying on past categories, acting on automatic pilot, not attending to new information, and fixating on a single perspective (Langer, 1989). It pertains to cognitive modes that are marked by automatic and limited information processing, little attention to detail, and restricted building of cognitive representations of task environments (Dunegan, 1993). When mindless, individuals exhibit behavior that is largely dictated by the past. They operate from a state of reduced attention, which often leads to the mechanical use of rule-based behaviors (Fiol and O'Connor, 2003), and they pay limited attention to the substantive elements of a situation. This causes much of the details of on-going, present situations to go unexamined (Langer, et al., 1978), or to be evaluated superficially (Dunegan, 1993).

When procedures are being standardized, mindlessness ambushes (Burgoon et al., 2000; Feldman, 2003; Langer and Moldoveanu, 2000), as the 'need for organizational participants to think' diminishes (Feldman, 2003: 728). In such cases, people behave rather routinely or habitually, and they adopt a less careful, critical, and purposeful attitude towards situations (Ryle, 1949). Their behavior involves a lack of seeing, taking notice, and being attentive (Dougherty and Takacs, 2004), and they work from a narrow focus of attention (Fiol and O'Connor, 2003), so that procedure-inconsistent information is excluded from consideration. This entails the risk that responses to situations are activated in an over-learned and automated fashion (Burgoon et al., 2000). As a result, standardized negotiation and contracting practices add little to interorganizational participants' comprehension of their situation and it prevents them from constructing meaning and building understanding. Standardization of negotiation and contracting practices reduces their inclination to make sense of the transactions they engage in. Consequently, expectations remain imperfectly articulated, and hubris and faddishness may prevail over active consideration of the consequences of interorganizational cooperation (Sampson, 2003). This can result in misunderstandings, misrepresentations, and misperceptions among transactors who are individually under the impression that they are engaged with one another in meaningful interactions (Burgoon et al., 2000; Langer and Moldoveanu, 2000). It precludes them from getting to know each other, from clarifying their objectives and intentions, and from strengthening their relationship. In summary, we suggest that the use of standard procedures for negotiating and contracting encourages mindlessness. If this is correct, the generic model presented in the literature, in which firm-level and transaction- or relational level factors influence formalization, and in which formalization subsequently influences interorganizational performance (Anderson and Dekker, 2006; Leiblein, 2003; Sobrero and Schrader, 1998; Stinchcombe, 2001), needs to be modified. We propose that the degree of standardization of negotiation and contracting practices moderates both sets of relationships. As standardization is argued to lead to mindlessness, firm-level and transaction- or relational level factors are no longer considered in great length during the negotiation and contracting period, reducing their impact on the degree

of formalization reached in a relationship. Similarly, the aspects of the cooperating firms and relationships that are covered in contracts are less likely to be helpful when things go wrong, and parties are less likely to revert to and depend on those contracts in future, diminishing the influence of formalization on interorganizational performance. This is captured in hypothesis 7.1.

Hypothesis 7.1: *In the context of interorganizational contracting, standardization of negotiation and contracting procedures reduces mindfulness, so that the associations between firm-level and transaction- or relational level factors and formalization, and associations between formalization and interorganizational performance become smaller.*

7.4 Method

Statistical analysis: Structural equation modeling

To assess the hypothesized relationships, we specify a structural equation model (see Anderson and Gerbing, 1988). Such a model consists of a set of linear equations that simultaneously test two or more relationships among directly observable and unmeasured latent variables (Shook et al., 2004). It allows one to test a system of structural equations, where a dependent variable in one relationship becomes an independent variable in a subsequent relationship. The advantage of structural equation modeling over other statistical techniques is that it enables simultaneous estimation of the fit of several structural equations, (Bagozzi, 1980), and it accounts for measurement error as well as unobservable constructs (Hulland, 1999). The structural model was developed in AMOS 5.0. The general form of the equation specifying the relationships between latent variables, in this software-program is:

$$\eta = B\eta + \Gamma\xi + \zeta \quad (1)$$

In which η is a vector of endogenous concepts, ξ is a vector of exogenous concepts, B and Γ are matrices of structural coefficients for the endogenous and exogenous concepts, and ζ is a vector of errors in the conceptual model. The measurement model for the endogenous latent variables in the model equals:

$$y = \Lambda_y\eta + \varepsilon \quad (2)$$

In which y is a vector of observed endogenous indicators, Λ_y is a matrix of structural coefficients and ε is a vector of errors in the measurement model. The measurement model for the exogenous latent variables in the structural model is:

$$x = \Lambda_x\xi + \delta \quad (3)$$

In which x is a vector of observed exogenous indicators, Λ_x is a matrix of structural coefficients and δ is a vector of errors in the measurement model. For identification purposes, scales of multiple indicator constructs are determined by fixing the loading of the indicator that a priori (i.e., theoretically) could be expected

to best represent that construct at a value of one. Fixed loadings are indicated by denoting $\lambda = 1$ for the “reference indicator”. Conforming to this general model, and based on the literature, we develop a recursive system describing the proposed path from antecedents, formalization, and performance. A visual presentation of the specified statistical model is presented in appendix B. As can be seen from this figure, we only incorporate relationships between antecedents when their existence appears highly plausible, making the model more meaningful than models in which antecedents are allowed to co-vary freely with each other (see, for example, Dekker, 2003). The model is estimated by a maximum likelihood procedure for structural equation models (Arbuckle and Wothke, 1999). To test for the moderating effects of standard procedures for negotiating and contracting on the relationships between antecedents, formalization, and performance, we split our sample of buyer-supplier relationships in a sub sample of relationships in which standard negotiation and contracting procedures are applied ($n=479$), and a sub sample for which this is not the case ($n=420$). To test our hypothesis, we compare the effect sizes for both sub samples of relationships.

Measurement

Our model encompasses several firm-level and transaction- or relational level factors that, according to the literature, influence formalization, such as measurability, relation-specific investments, transaction complexity, reputation, firm size, and the existence of alternative options. *Measurability*, for example, is reputed to be positively related to formalization, as managers try to find decision rules, information sources, and structural designs that provide adequate understanding to cope with measurability problems (Daft and Lengel, 1986; Poppo and Zenger, 2002). It is captured by three items. Respondents had to indicate how difficult it was for their organization to compare this product with similar products, how difficult it was for their organization to compare the price-quality ratio of potential suppliers, and to what extent it was difficult or hard to evaluate the quality of the product at the time of delivery. Response categories followed a 5-point Likert-scale (1= ‘very easy,’ 5= ‘very difficult’). The items are reverse-coded, after which a Cronbach’s α of 0.79 remains for the scale, which is above the guideline of 0.7 for modest composite reliability (Nunnally, 1978). *Relation-specific assets* concern investments that have the highest potential value in a focal relationship; redeployment of these assets outside the relationship diminishes the assets’ value or is simply impossible (e.g. Klein et al., 1978; Subramani and Venkatraman, 2003). According to transaction cost economics, exchanges that involve significant relation-specific investments can encounter ‘hold-up’ or ‘opportunism’ problems (Williamson, 1985), hence, the greater the specificity of investments, the more complex the contract (Bensaou and Anderson, 1999). Consistent with Dekker (2003) and Poppo and Zenger (2002), we measure relation-specific investments by three indicators reflecting the costs related to switching to another supplier or product. The questions concern damages – in terms of time and money – which are incurred when transacted products have to be replaced. The items concern the ‘purchase a new product,’ the ‘re-education of personnel,’ and ‘re-entry of data.’ Cronbach’s α for the scale amounts to 0.75. *Transaction complexity* relates, among others, to the scope of a transaction (Oxley and Sampson, 2004), the

number of partners involved, and the degree of technological or organizational interdependency between the partners (Kumar and Van Dissel, 1996). Researchers have argued that complexity needs to be controlled through rules, scheduling or plans (Steensma and Corley, 2000), and that higher degrees of complexity call for more coordination (Gulati and Singh, 1998), implying that governance costs and administrative overhead rise with the level of complexity (Williamson, 1985). Congruent with Dekker (2003), we measure complexity by two indicators. The first indicator captures the scope of a transaction. It is a count-measure of the number of product types involved in a transaction. The second indicator measures the degree of interdependency between partners. It is measured by dividing the 18 product types into product categories entailing divergent degrees of complexity (1= most simple product categories, 5= most complex product categories). We measure the overall complexity of the transaction by both the number of transactions and the complexity level involved with these transactions. Cronbach's α for this measure is 0.71. *Reputation* refers to a focal organization's knowledge of the partner's likely behavior, and of its capabilities and resources (Hill, 2001a). As reputation reduces the likelihood that partners behave opportunistically, it is believed to reduce the need for relying on complex and costly contracts (Eggleston et al., 2000). Congruent with Carson et al. (2006), the items we use refer to the importance of 'the reputation and reliability of the supplier,' 'the reputation and reliability of the product,' and 'the general impression of the supplier and its employees'. The resulting scale has a Cronbach's α of 0.73. Concerning firm size, the majority of studies presuppose a positive relationship with formalization (Oxley, 1997). We measure the *size of a buyer* by the number of employees (Heiman and Nickerson, 2004; Muthusamy and White, 2005), and turnover (see also Heide, 2003). As the distributions of both proxies are skewed, the logarithm is taken of these values. Cronbach's α for the scale equals 0.73. *Alternative options* increase one's 'ability to exit from existing relations' Palay (1996: 49), thereby offering an alternative to contractual safeguards. Cooper and Slagmulder (2004: 17) offer an example of Isuzu, an Asian car manufacturer, which 'used direct competition between its major suppliers to ensure that the suppliers were as innovative as possible. When a supplier failed to remain competitive, Isuzu punished that firm by awarding it slightly less volume than in previous years.' In these cases 'interests were secured because of the existence of potential alternatives and not necessarily because of actual recourse to those substitutes' (Masten, 1996: 50). Consistent with Jap and Ganesan (2000), we measure alternative options by two indicators referring to 'the number of alternative suppliers that could have arranged a similar IT-solution' and 'the number of alternatives for this product' (1='minimal', 5='very high'). Cronbach's α for this scale equals 0.72. The degree of *formalization* is constructed from two proxies. The first proxy is constructed as the sum of 24 technical specifications that could possibly be recorded in a contract between a supplier and a buyer, such as clauses on the definition of system functions; memory space; and system architecture. Respondents were asked to rate to which degree these aspects of a transaction were specified or defined in the contract (1= 'very globally', 5= 'very detailed'). The second proxy involves the respondent's answers regarding the presence or absence of 24 contract clauses.

Price determination	Liability supplier	Restriction product use
Price-level	Force majeure supplier	Non-disclosure buyer
Up-dating	Arbitration arrangement	Settlement R&D costs
Joint management	Technical specifications	Termination period
Price changes	Warranties supplier	Insurance supplier
Payment terms	Quality (norms)	Service period
Sanctions late payment	Intellectual property	Reserving spare parts
Delivery time	Protection product	Maintenance period

Individual contract terms receive a value of one when the respondents indicate that they were included as a clause in the contract, whereas they were coded zero when the subject was only arranged verbally, or when it was not arranged at all. The first proxy for formalization is then calculated as a count measure of these contractual agreements. The factor scores for both proxies range between 0.62 and 0.71, indicating a reasonable fit. *Standardization of negotiation and contracting procedures* applies when procedures are uniform, well established by usage, and widely recognized as acceptable. It is captured by a dummy variable. Respondents, all from the buyer-side of the dyads, were asked whether a standard procedure was used by their firm during negotiations and contracting. When respondents answered that this was not or hardly the case, the variable received a value of zero, while on all other occasions the value was set to one. Finally, *interorganizational performance* is measured by the extent to which eleven different types of problems have occurred in a relationship (1='not', 5='into a large extent'), and by the types of actions that could be taken to solve these problems (0='no', 1='yes'). The occurrence of problems is then calculated as the maximum value respondents given to one of the eleven problem categories. The extent to which corrective actions were undertaken is measured by the number of actions that buyers took as a reaction to problems related to the transaction. Cronbach's alpha for the scale is 0.84. Analogue to Rooks (2002), the validity of the measure was assessed by regarding its relationship with other performance variables, such as the report mark for the product, the report mark for the supplier, and the degree to which the buyer would recommend the supplier to other firms. The results confirmed our confidence in the validity of this measure.

Problems:	Actions:
Exceeding delivery period	Deliberate with supplier
Exceeding price / budget	Refer to agreements made
Product incomplete	Contact higher management
Product too slow / too limited	Inform other clients of supplier
Deviance of agreed on specification	Postpone payment period
Incompatibility with other products	Postpone payment
Installation too quick / careless	Claim damage
Support too summarily	Call for arbitration
Service too slow / late	Other juridical steps
Necessary adaptations slow or late	Finish relationship
Insufficient / unclear documentation	Defer agreement

7.5 Results

Table 7.2 exhibits the correlation matrices for both sub-samples. In order to assess the adequacy of the reflective measurement model, checks were performed on (1) individual item reliabilities, (2) the convergent validity of the measures associated with individual constructs, and (3) discriminant validity between constructs (Hulland, 1999). The Kaiser-Meyer-Olkin measure of sampling adequacy equals 0.79, indicating that factor scores could be used as reliable indicators of discriminant validity. Appendix C contains factor scores for all items on their respective variables, all displaying acceptable coefficient alpha's (see Hulland, 1999). It also exhibits different measures for model fit. Following Anderson and Dekker (2006), we assess whether a fixed measurement model for both sub samples is appropriate. The model shows configural invariance (i.e. items load on similar factors between groups) and metric invariance (i.e. no meaningful differences exist in the factor loadings between groups).

TABLE 7.2
Correlation matrices for both sub samples*

No standardization	Mean	SD	1	2	3	4	5	6	7	8
Measurability	9.01	2.70	1.00							
Asset-specificity	8.85	3.04	.38	1.00						
Complexity	5.53	1.98	.33	.40	1.00					
Reputation	11.3	2.13	-.01	.21	.18	1.00				
Size buyer	5.84	.86	.04	.12	.17	.04	1.00			
Alternative options	5.17	1.89	-.23	-.21	-.16	.01	-.14	1.00		
Formalization	62.0	26.2	.08	.31	.42	.32	.20	-.08	1.00	
Performance	5.10	1.74	-.14	-.29	-.18	-.10	-.19	.07	-.41	1.00
Standardization	Mean	SD	1	2	3	4	5	6	7	8
Measurability	8.22	2.58	1.00							
Asset-specificity	8.47	3.04	.40	1.00						
Complexity	5.15	2.05	.27	.40	1.00					
Reputation	11.4	2.07	.02	.22	.22	1.00				
Size buyer	5.75	.89	-.06	-.01	.01	.01	1.00			
Alternative options	5.51	1.97	-.27	-.25	-.24	.07	-.08	1.00		
Formalization	63.1	27.9	.24	.35	.40	.25	.16	-.18	1.00	
Performance	4.87	1.58	-.28	-.23	-.22	-.08	-.26	.09	-.39	1.00

* Correlations with binary variables consist of Kendall's tau-b. Correlations higher than .072 are significant at the 0.05-level, whereas correlations higher than .085 are significant at 0.01-level. N=420 for the sub sample in which no standard negotiation and contracting procedures are applied. N=479 for the sub sample in which they are used.

Assessing a model's fit is one of structural equation modeling's most controversial aspects. Most fit indices ascertain whether the covariance matrix derived from the hypothesized model is different from the covariance matrix derived from the sample. A Chi-square test serves as the most common fit measure (Shook et al., 2004). In general, a non-significant value for the ratio of Chi-square over degrees of freedom of less than 3.0 indicates a good fit, meaning that the model is not significantly different from the underlying data (Rothaermel and Deeds, 2004). The likelihood ratio Chi-square statistics are 2.29 for the sub sample without standard procedures and 1.64 for the sub sample with standard procedures, indicating reasonable fits for the models. As fit measures based on the Chi-square statistic have often been criticized for being inflated by sample size (Jöreskog and Sörbom, 1993), we also calculate other fit measures. The Root Mean Square Error of Approximation has recently been recognized as 'one of the most informative criteria in covariance structure modeling' (Byrne, 1998: 112). According to Byrne, values less than 0.08 represent reasonable errors of approximation, whereas values less than 0.05 indicate good fit. The RMSEAs for both sub samples are equal to .055 and 0.043 indicating medium to good fits for both sub samples. In addition, MacCallum et al. (1996) recommend that a ninety percent confidence interval is reported around the RMSEA value, in order to reflect the precision of the estimate. Narrow confidence intervals would argue for good precision of the RMSEA. The ninety percent confidence interval for both sub samples ranges between acceptable values, indicating that one can be reasonably confident that values of the RMSEA do not exceed critical values. Moreover, we provide the Normed FIT Index (NFI) and the Comparative Fit Index (CFI), which range from zero to one with values higher than 0.90 indicating an acceptable fit to the data (Bentler, 1992). For both sub samples, the NFI is close to 0.90, and high values for the CFI – .927 and .952 respectively – lead to the conclusion that an acceptable fit to the data exists. A final goodness-of-fit statistic consists of Hoelter's (1983) critical N. This measure differs substantially from the measures previously discussed in that it focuses directly on the adequacy of sample size rather than on model fit (Byrne, 1998). The purpose of this measure is to estimate a sample size that would be sufficient to yield adequate fits for a Chi-square test. Hoelter (1983) proposes that a value in excess of 200 is indicative of a model that adequately represents the data. In this case, Hoelter's N equals 239 and 332, indicating that results are not influenced by insufficient sample sizes, and that our model has adequate power (Shook et al., 2004).

Now that we have assessed that the model adequately fits the data, we proceed with testing our hypothesis. To do so, we have to compare the proposed relationships between variables for the sub sample in which no standard procedures for negotiating and contracting are used with the relationships for the sub sample in which they are used. Figure 7.3 visualizes the moderating influence of standard procedures for negotiating and contracting on the relationships between five firm-level and transaction, or relational level factors and formalization, and on the relationship between formalization and interorganizational performance. Table 7.3 exhibits the standardized direct effects for both sub samples, which are generally consistent with previous research on

the same data (see Batenburg et al., 2003; Buskens, 2002). Our hypothesis on the moderating effects of using standard procedures for negotiation and contracting is only partly supported. From the results it accrues that relationships between formalization and asset-specificity, the importance of reputation, transaction complexity and the size of a buyer are of a smaller magnitude for the sub sample of transactions in which standard procedures for negotiation and contracting have been used. This also accounts for the relationship between formalization and interorganizational performance. However, the relationship between measurability and formalization is of a larger magnitude in the sub sample of transactions in which standard procedures were used, contradicting our expectations. We can thus conclude that our hypothesis holds, except for this relationship, on which we elaborate in the discussion section.

FIGURE 7.3
Moderating effect of standard procedures on relationships between formalization, its antecedents and performance

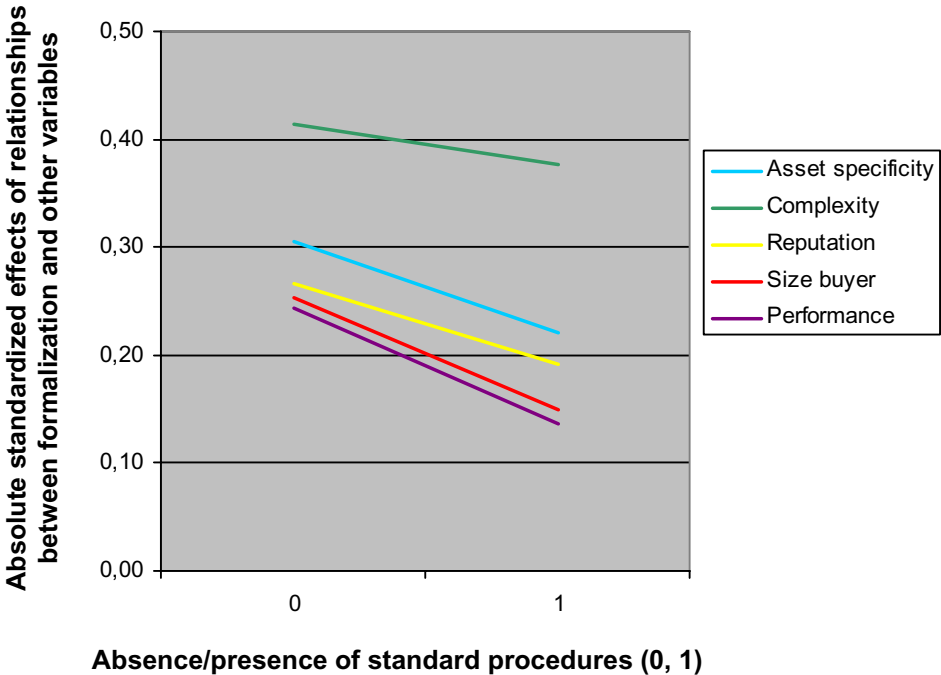


TABLE 7.3
Comparison of standardized effects for both sub samples

			No standard procedures		Standard procedures	
			B	Sig.	B	Sig.
Measurability	→	Formalization	.110		-.151	**
Asset-specificity	→	Formalization	.305	***	.220	***
Complexity	→	Formalization	.414	***	.376	***
Reputation	→	Formalization	.267	***	.192	***
Size Buyer	→	Formalization	.254	***	.149	***
Formalization	→	Performance	-.244	***	-.136	**

Correlations significant at the 0.05-level (**), and the 0.01-level (***)

To assess the threat of reverse causality – implying that the relationships between the proposed antecedents, formalization and interorganizational performance have a reversed direction – two procedures have been applied. First, analogue to Rothaermel and Deeds (2004) and in line with recommendations of Shook et al. (2004), several alternative recursive models were tested with structural equations describing reverse paths. These models eventuated in less acceptable overall fits with the data, and rendered several paths insignificant. Second, we compared the chronological order with which the constructs appear in the model with the chronological order of effects that one would expect in reality. For each relationship between two constructs, the reverse of the relationship was specified and discussed in order to assess whether this alternative was plausible or not. The temporal ordering of variables presumed in our model appeared most plausible.

7.6 Discussion

In this chapter, we elaborated on the standardization of negotiation and contracting practices. Although the application of standard contracts and standard procedures for negotiating and contracting is widespread, academic studies on this subject are still sparse. In this theme, we attempted to redress this imbalance between practice and research, and we examined how a discussion of standardization in interorganizational governance research could shed new light on the role of formalization in interorganizational relationships. We addressed the following research questions:

RQ8: What are the advantages and disadvantages of using standard form contracts in interorganizational relationships?

RQ9: What influence does the introduction of standard procedures for negotiating and contracting have on the generic research model for formalization?

Key findings

We stipulated an overview of the advantages and disadvantages of contract standardization. We advanced that the most fundamental drawback of contract standardization has to do with the fact that it precludes the creation of shared expectations or the “meeting of minds”, and that it encourages “mindless” behavior during negotiation and contracting practices. This hypothesis was empirically assessed by an analysis of contracting practices in 911 buyer-supplier relationships. Structural equation modeling generally supported the idea that the use of standard procedures for negotiation and contracting generally diminishes parties’ attention for the substantive details of a transaction and that it reduces the influence of formalization on interorganizational performance. There was one exception, consisting of the relationship between measurability and formalization, which was stronger for the subsample with standardized negotiating and contracting practices. This may be caused by the fact that standardization of negotiation and contracting practices is frequently accompanied by a low degree of information acquisition and information processing, which leaves measurability problems unsolved, and increases its impact on formalization. When negotiation and contracting processes do not follow standardized patterns, instead, measurability problems are more likely to be alleviated by the collection and processing of information, which then tempers the effect of measurability problems on formalization (see also theme one).

Theoretical and practical implications

The findings of our research imply that transactions and contracts can no longer be studied on a case-by-case basis (Goetz and Scott, 1985; Klausner, 1995), as procedures in one exchange influence other contracts or parties to other contracts (Klausner, 1995). Our findings also exemplify that the process by which formalities come about partly determines what role they play in interorganizational relationships. In line with previous inquiries (Hatch, 1999; Ring and Van de Ven, 1992), we therefore encourage researchers to complement research on organizational structures with inquiries into the structuring processes from which they emanate. The results indicate that research on structuring processes requires new impetus, and that the logic of interorganizational theorizing should be drawn away from structured entities, outcomes and end-states, towards the underlying thought-structuring processes, which produce these outcomes (see also Chia, 1997: 703; Hatch, 1999: 82). We expect that such a shift in attention could explain, for example, why ‘human beings can possess high intelligence and yet evince frequent lack of intellectual awareness when making decisions’ (Sharps and Martin, 2002: 273)³¹, and why contracts are generally simple, although predictions derived from theory suggest they should be complex (Eggleston et al., 2000). Our findings also indicate that standard procedures for negotiation and contracting may result in a failure to communicate the content of a promise or to define the rights exchanged between partners (Goetz and Scott, 1985). By de-

³¹ Sharps and Martin (2002: 272-273) offer the following example: ‘In September 1999, NASA lost a Mars orbiter because the scientists working on the mission did not convert English units to metric units.’

contextualizing the contracting process, standard procedures reduce the degree to which parties can 'create a bigger transactional pie in a world where parties' incentives are misaligned and [where] they need to coordinate the production of information, specify future rights, duties, and procedures, and allocate risks' – the central aim of contracting (Hill and King, 2004: 890). In other words, we ascertain that the use of standard procedures for negotiation and contracting potentially leads to reduced mindfulness by contracting parties, which diminishes the usefulness of interorganizational contracts. This conforms to a description of the role of the contract in an alliance between two firms aiming to developing a packaging machine by Klein Woolthuis et al. (2005). These authors find that the adoption of a standard contract was not accompanied by much thought. As a result, 'the contract did not provide a source to fall back on when the relationship broke up' (Klein Woolthuis et al., 2005: 829).

Our analysis has several practical implications as well. First, it indicates that care should be taken not to eliminate sensemaking efforts from negotiation and contracting processes. Instead, mindfulness should be nourished in order to enable participants in interorganizational relationships to grasp new opportunities and prevent them from initiating non-sensible relationships. In order to do so, standardization of negotiating and contracting processes could be accompanied by the hiring of sensitive, attentive and vigilant staff. Organizational departments that support and supervise interorganizational governance processes could use contract management tools to gather information and prevent non-sensible relationships from occurring. A second and related option concerns the development of a "contracting capability". Analogue to "alliance capabilities" – which are directed at the institutionalization and adoption of earlier alliance-experience in novel interorganizational relationships (Draulans et al., 2003; Dyer et al., 2001; Kale et al., 2002) – organizations might develop contracting capabilities to harness and exploit experiences derived from earlier contractual agreements in future collaborative relationships (Reuer and Zollo, 2005). As they apply to entire portfolios of contracts, such contracting capabilities stress the significance that has recently been attributed to successful relationship management on portfolio level (Heide, 2003; Wuyts et al., 2004).

A contracting capability can be created by comparing the contract performance of various relationships, or by casting light on entire sets of contractual relationships with one partner. Moreover, regular visits of partners could contribute to making sense of interorganizational relationships, and to the signaling of issues, problems or clues that are not captured in standardized contracting systems. A third possibility to restrict mindless contracting consists of the incorporation of "sensemaking triggers" in contracts and procedures for negotiating and contracting. Sensemaking triggers "force" managers of cooperating organizations to ask themselves questions about the underlying logic of relationships, the anticipated risks, costs, investments and returns involved, and the possibilities to push performance to higher levels. Sensemaking triggers can form the impulse for the explication of expectations of both parties, possibly leading to a better understanding of the various factors that might play a role in interorganizational

relationships (Vlaar et al., 2005). They comprise intentionally manipulated elements of contracts and negotiating and contracting procedures that are included to elicit more thoughtful, creative and flexible states of mind (Burgoon et al., 2000: 112).

Limitations and opportunities for future research

This chapter contains several limitations, indicating opportunities for future research. First, one has to realize that it is impossible to process every piece of information mindfully (Langer, 1989). After all, in today's world the scarce resource is typically not information, but the amount of mindful attention that decision makers allocate to making the information meaningful (Hansen and Haas, 2001). As one cannot mindfully process every piece of information, and as there are significant costs associated with creating and maintaining mindfulness, it becomes essential to discover 'when standard operating procedures are appropriate and when they are not' (Karina, 1998: 202). Stated differently, it becomes worthwhile to investigate *when* mindfulness or standardization have the largest payoffs. In this respect, standardization is believed to be a very poor strategy, for example, in case organizations face unexpected contingencies (Roberts and Bea, 2001). One could also investigate how the degree of standardization varies between different institutional contexts. Hill and King (2004: 890), for example, argue that German contracting 'cuts short the costly and inefficient "arms race" in which U.S. transacting parties and their lawyers too often engage in their negotiation and drafting of contracts. It creates and uses "good enough" standardized solutions to common problems faced by transacting parties. By some accounts, this results in German agreements being one-half or two-thirds the size of otherwise comparable U.S. agreements (Hill and King, 2004). This issue receives more attention in theme six, where we investigate the antecedents of standard contracts.

Second, our moderating variable was presented as being dichotomous, while it might be more accurately described as a continuous variable. In future research, negotiation and contracting processes may be depicted and measured as being more or less standardized. Third, the chapter offered only few insights into factors that influence whether standard procedures and standard contracts are applied, and when they ought to be (see theme six). Do prior relationships, for example, influence the use of standard procedures? Here, Madhok (1995) has advanced that when parties have previously cooperated, the role of the contract is more in the nature of a routine or a standard operating procedure. Hill and King (2004: 926) add that 'protracted negotiations involved in elaborate customization may be more useful for parties coming to know each other for the first time.' A final option for future research concerns the fact that the majority of research on mindfulness still pertains to crisis situations in high reliability organizations, including those involving flight operations (Weick and Roberts, 1993; Weick and Sutcliffe, 2001), ferries and cruise-ships (Roberts and Bea, 2001) and chemical and nuclear plants (Mitroff, 2001; Weick, 2001). The chapter demonstrates that mindfulness may influence everyday practices in "normal" organizations, indicating a need for incorporating mindfulness in organizational research (see also Feldman, 2003; Fiol and O'Connor, 2003; Weick and Roberts, 1993).

8 THEME 5 – EVOLUTION OF TRUST & FORMALIZATION

'While there are numerous examples in the literature where control chases out trust and situations in which trust seems to remove the necessity for control, there are equally as many examples of trust and control being complementary, or going hand in hand.'

Bachmann et al., 2001: v

Summary

In this conceptual chapter, we develop an integrative perspective on the evolution of formalization and trust in interorganizational relationships. First, we sketch how trust and formalization are associated with interorganizational performance. In the second part of the chapter, we discuss how trust and formalization evolve in interorganizational relationships. We argue, among others, that both governance forms tend to develop along self-reinforcing paths, and we advance that levels of trust and formalization in early stages of cooperation are crucial to the unfolding of both governance modes in later stages of development. We capture our assertions in tentative propositions and in an integrative conceptual framework, which reconcile hitherto fragmented views on the evolution of formalization and trust in interorganizational relationships.

8.1 Introduction

Due to a significant increase in the number of alliances, outsourcing relationships and other forms of inter-firm exchange, and the control problems associated with these relationships, issues of interorganizational governance have attracted growing attention from academics and practitioners (e.g. Gulati and Singh, 1998; Kale et al., 2002; McEvily et al., 2003a). The corresponding literature distinguishes several governance forms by which cooperating parties can achieve control, primarily emphasizing trust and various forms of formalization (Bijlsma-Frankema and Koopman, 2004; García-Canal et al., 2003; Luo, 2002; Poppo and Zenger, 2002). Over time, different theoretical perspectives on the significance of trust and formalization and on the interplay between them have emerged. In particular, one can distinguish contributions that illuminate: (1) how trust and formalization act as substitutes (e.g. Chiles and McMackin, 1996; Das and Teng, 2001; Dyer and Singh, 1998; Gulati, 1995; Inkpen and Currall, 2004); (2) how trust and formalization function as complements (e.g. Bradach and Eccles, 1989; Deakin and Wilkinson, 1998; Mayer and Argyres, 2004; Poppo and Zenger, 2002; Sitkin, 1995); (3) the effects of trust and formalization on interorganizational performance (e.g. Luo, 2002; Kern, 1998; Sydow and Windeler, 2003); and (4) the self-reinforcing character of both governance forms (e.g. Ghoshal and Moran, 1996; Inkpen and Currall, 2004; Zand, 1972).

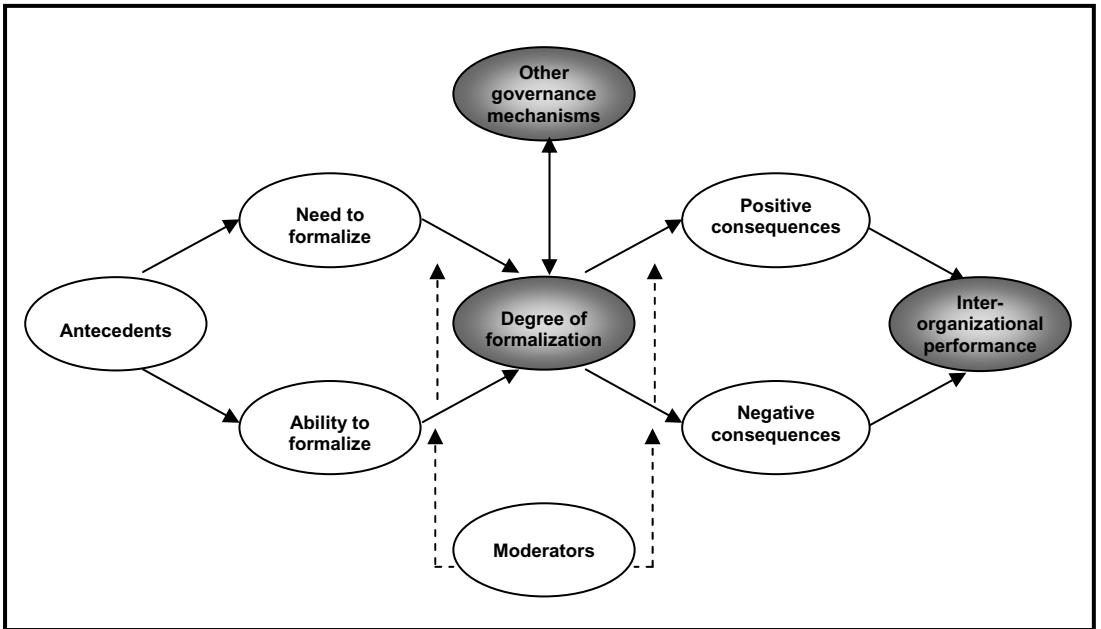
Despite these contributions, the relationship between trust and formalization remains far from clear (Maguire et al., 2001; Sydow and Windeler, 2003), and much theoretical input is still needed to understand how they work as governance mechanisms (Bachmann, 2001). In particular, their role as emerging and evolving

concepts in the process of relationship development is not well understood (De Wever et al., Forthcoming; Inkpen and Curall, 2004), and little attention has been paid to the evolution of trust and formalization during cooperative relationships (for notable exceptions, see Ferrin et al., 2005; Klein Woolthuis et al., 2005; Mayer and Argyres, 2004; Serva et al., 2005). In line with this observation, calls have been issued for a more integrative approach towards theory development and more dynamic representations of the trust-control nexus (Bijlsma-Frankema and Costa, 2005; Bijlsma-Frankema and Koopman, 2004). This chapter therefore addresses the following research question: How do trust and formalization evolve within interorganizational relationships? This question pertains to the shaded areas in the research framework depicted in Figure 8.1.

The chapter contributes to the literature in two ways. First, it transcends current work by making initial steps towards systematically integrating a range of contributions on the role of trust and formalization in interorganizational relationships (see Bachmann, 2004; Bachmann et al., 2001; Bijlsma-Frankema and Koopman, 2004; McEvily et al., 2003a). We shift the attention from one-sided views on the performance implications of trust and formalization – either emphasizing positive or negative effects – towards a perspective in which intermediate levels of both governance forms are considered most conducive to interorganizational performance. Moreover, we advance that there is not only a need for basic levels of trust and formalization, but we indicate that extreme values of both governance forms have to be circumvented too. Furthermore, we explain that trust and formalization can act as substitutes as well as complements, thereby reconciling different arguments on the relationship between both governance forms, and explaining why empirical research has not yielded decisive support for one stance over the other (Bijlsma-Frankema and Costa, 2005). Second, we describe how trust and formalization evolve in interorganizational relationships, something which has received little attention in the literature so far (Inkpen and Currall, 2004; Klein Woolthuis et al., 2005). We argue that both governance forms tend to develop along self-reinforcing paths, and we indicate why levels of trust and formalization in early stages of cooperation are crucial to the development of both governance modes in later stages of development. By doing so, we extend prior research with a dynamic perspective on the role of trust and formalization in collaborative relationships.

The chapter is organized as follows. We start with a definition of trust and formalization, after which we discuss how both governance forms relate to interorganizational performance from a static perspective. In the second part of the chapter, we develop a more dynamic perspective, capturing the evolution of trust and formalization. We elaborate on, among others, the significance of starting conditions – being the initial levels of trust and formalization – and indicate that there is a high propensity for self-reinforcing paths to develop. We conclude with a brief summary, limitations of our study and opportunities for further research.

FIGURE 8.1
Research framework – theme five



8.2 The influence of trust and control on interorganizational performance: A static perspective

To facilitate a comprehensive and coherent description of the influence of trust and formalization on interorganizational performance, proper definitions of these concepts are required. Rousseau et al. (1998: 395) define trust as ‘a psychological state comprising the intention to accept vulnerability based upon positive expectations of the intentions or behavior of another.’ This definition implies that trust involves choice (Luhmann, 1988), and the existence of risk (Mayer et al., 1995). Nooteboom (1999: 203) explicitly addresses these points in his definition of trust, stating that it ‘entails that one does not expect to be harmed by a partner even though she has both the opportunity and the incentive to be opportunistic.’ This indicates that trust consists of a subjective state of positive expectations (Das and Teng, 2001), and that the partner and its behavior are the objects of trust (Inkpen and Currall, 1997). In this chapter, we further focus on the trust that managers of interorganizational relationships have in their partners, or trust at the micro-level (e.g. see Dodgson, 1993). Accordingly, following Mayer et al. (1995: 712) we define trust as ‘the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party.’ Expectations of trustworthiness then encompass an actor’s belief in the ability of a partner to accomplish a task, its belief in the goodwill or positive intentions of the partner towards the trustor, and its perception that the trustee

adheres to acceptable values (Mayer et al., 1995; Serva et al., 2005). The second governance form that we discuss, formalization, is considered to be a regulatory process by which elements of a system are made more predictable (Das and Teng, 2001). It aims at establishing reliability by codifying and enforcing inputs, outcomes, and/or interorganizational activities (Bijlsma-Frankema and Costa, 2005; Ouchi, 1979). The principal exponent of formalization in interorganizational relationships consists of contractual planning, a process of 'projecting exchanges into the future' (Macneil, 1980: 4). This process includes: defining performance, duties, and rights with regard to future circumstances; defining what should happen when parties do not hold to agreements; and assessing in how far the contract can be legally enforced (Macaulay, 1963). It eventuates in promises or obligations that are laid down in formal contracts (Macneil, 1980).

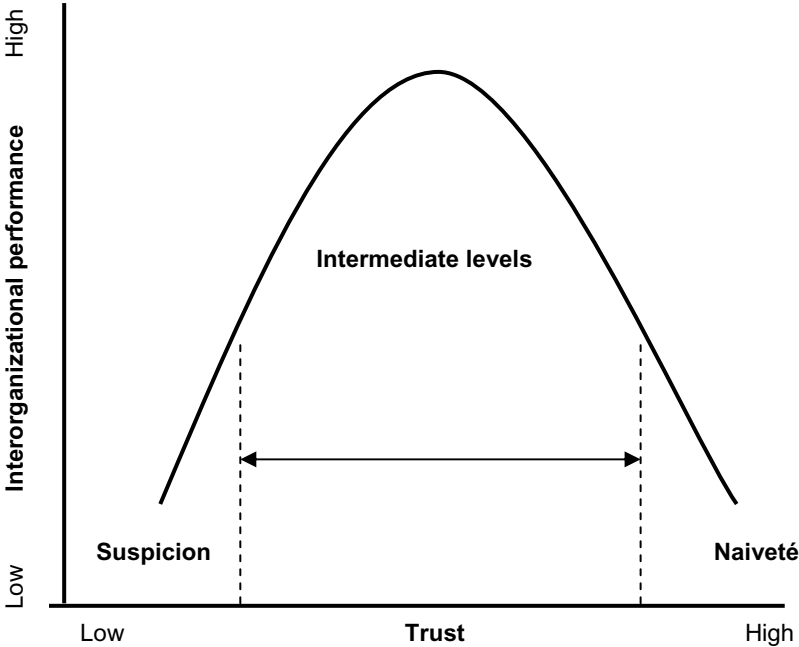
As becomes clear from these definitions, trust and formalization differ in their underlying mechanisms. Trust resides with individuals, while formalities are external mechanisms of control (Malhotra and Murnighan, 2002). Besides, where trust is built on positive assumptions about a partner's willingness and ability to cooperate, formalization is based on the negative hypothetical possibility regarding a partner's behavior and actions (Bachmann, 2001). We argue that both assumptions are valid, implying that other-oriented behavior – motivated by joint interests – and more egoistic, self-interested behavior co-exist. Or, as Dasgupta (1988: 53) stated 'we are all at once both egoists and altruists,' implying that interorganizational governance structures are fraught with tension, in that potential gains offer incentives to sustain relationships, while profit appropriation concurrently weakens such incentives (Foss and Foss, 2005; Gulati and Singh, 1998; Heiman and Nickerson, 2004; Madhok, 1995; Madhok, 2002).

In assessing the influence of trust and formalization on interorganizational performance, we consider both the outcomes achieved within a relationship, and the conduct of partners and the interaction between them (Ariño, 2003; Madhok and Tallman, 1998). Outcome performance captures the effectiveness and efficiency of relationships, including the extent to which strategic goals are fulfilled (Ariño, 2003; Hoang and Rothaermel, 2005), and whether parties adhere to schedules and budgets. Following Madhok and Tallman (1998) and Chaserant (2003), outcome performance is believed to be influenced by the conduct of partners and the interaction between them, in the form of relational quality (Ariño, et al., 2001), the ease or smoothness of cooperation (Luo, 2002), the extent to which conflicts prevail within the relationship, and partners' satisfaction with interorganizational processes (Poppo and Zenger, 2002). This conceptualization of interorganizational performance is supported by findings from De Rond (2003) on two alliances between pharmaceutical and biotechnology firms, which indicate that performance assessments are based on rational considerations (e.g. economic or strategic), as well as on cognitive processes of individuals within these relationships.

Now that we have defined the core concepts in this study, we continue with an assessment of the relationships between trust, formalization, and

interorganizational performance. Congruent with De Wever et al. (Forthcoming), Figure 8.2 depicts the level of interorganizational performance as a curvilinear function of the level of trust that managers have in a partner. We assume that basic levels of trust and formalization function as prerequisites for interorganizational cooperation as they help to generate and maintain interaction and social order (Bachmann et al., 2001; Inkpen and Curall, 2004; Luhmann, 1979; Reed, 2001). In particular, '[I]n the face of unknown conditions, unintended consequences, existing zones of uncertainty, and the prevailing dialectic of control, social interaction always requires some trust' (Sydow and Windeler, 2003: 79). Otherwise, interorganizational relationships would be pervaded by very high levels of uncertainty, causing managers to continually question the motives and competences of their partners (Das and Teng, 2001; McEvily et al., 2003a). In such cases, managers become less willing to take risks, and they refrain from sharing perspectives and knowledge (Bijlsma-Frankema, 2004; March and Olsen, 1975). This makes it harder for them to alleviate the problems emanating from functional, organizational, and cultural differences (Mohr and Puck, 2005). It also complicates the handling of conflicts, and it obstructs the expression of diverging views (Child and Rodrigues, 2003).

FIGURE 8.2
Relational governance and interorganizational performance



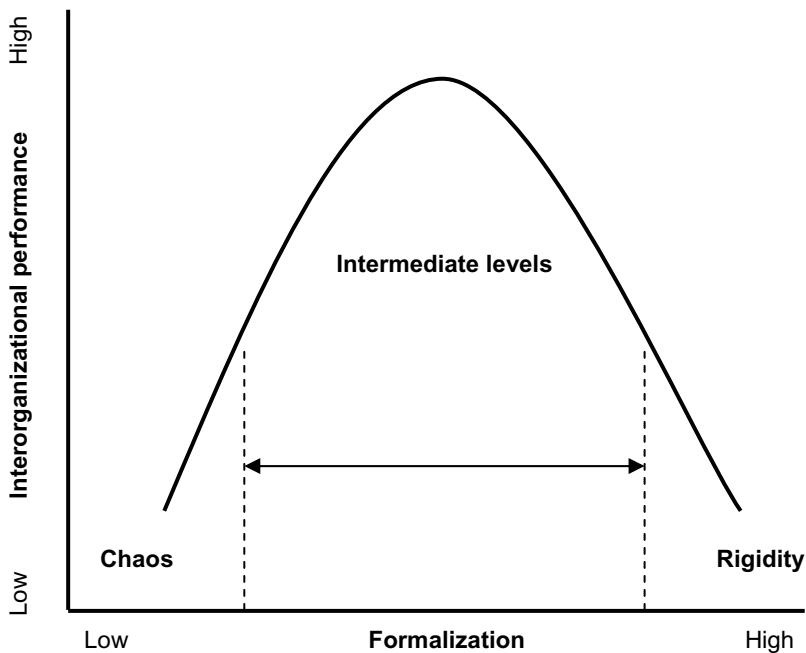
However, whereas trust is commonly accepted to have a variety of positive effects (Dirks and Ferrin, 2001) it is also known to have inescapable downsides (Anderson and Jap, 2005; Carson et al., 2003; Jeffries and Reed, 2000; McEvily et al., 2003b). Even if trust has been established successfully, it remains a fragile mechanism (Dodgson, 1993). Eventually, 'the trustor can never completely rule out that the trustee sees it as advantageous to cheat' (Lane and Bachmann, 1997: 229). It appears that, if the incentives are there, even a trustworthy party can be relied upon to be untrustworthy (Dasgupta, 1988). 'Over-trusting' partners can become easy targets for exploitation by greedy partners (Wicks et al., 1999; Zeng and Chen, 2003). In this respect, Anderson and Jap (2005: 78) advance that 'while cosy relationships sound good in theory, such relationships also provide an opportunity for covert activities designed to systematically cheat a partner.' Similarly, Langfred (2004) argues that, under certain conditions, trust can be harmful, as it reduces the inclination to guard against opportunistic behavior (e.g. to monitor and safeguard), and as it encourages actors to suspend judgment of others. This could manifest itself in giving others the benefit of the doubt when uncertainties arise or potential conflicts emerge, and giving second chances more frequently (Hoetker, 2005). Trust may also be based on systematic biases, which can result in flawed and costly judgments (Jeffries and Reed, 2000; McEvily et al., 2003b), and in problem denial. Managers asking themselves 'Our partners are so trustworthy; how could they be exploiting us?' may be reminiscent of such cases (Anderson and Jap, 2005: 76).

In fact, trust may result in a situation in which 'one takes the relation for granted and does not continuously think about opportunities to gain extra advantage from it, nor does one consider the other to do so' (Klein Woolthuis et al., 2005: 816). Anderson and Jap (2005) offer an example of such complacency in their description of a relationship between an automaker and one of its suppliers. One of the partners invested heavily in this relationship, which eventuated in a high level of mutual trust. This was abused by the supplier, which 'cut corners in a calculating manner, weighing the costs, benefits, and risks as though it were pricing an insurance policy' (Anderson and Jap, 2005: 77). Such examples show that trust sometimes 'binds and blinds, making economic actors insufficiently vigilant and excessively vulnerable' (McEvily et al., 2003b: 98). High levels of trust can thus lead to naiveté and a take-it-for-granted mind-set in which relationships are put on "cruise control" (Anderson and Jap, 2005). This is particularly likely to occur when high degrees of ambiguity reduce the accuracy with which assessments of a partner's trustworthiness can be made (Carson et al., Forthcoming). Several authors have therefore concluded that both very low and very high levels of trust may have harmful consequences (Anderson and Jap, 2005; Barnes, 1981; Fisher and Ury, 1981; Kern, 1998; Langfred, 2004; Wicks et al., 1999). Over-investments in trust may lead to the misallocation of precious resources and to participants taking unnecessary risks, whereas under-investments in trust may cause parties to miss out on opportunities to create cost savings or develop new organizational capabilities (Wicks, Berman, and Jones, 1999). In line with this, Langfred (2004: 391, 393) argues that 'a little skepticism never hurt anyone' and that it is important to 'balance the study of the benefits of

trust with the acknowledgement that those benefits have limits.’ Collectively, these observations suggest that intermediate levels of trust might yield the most favorable performance outcomes.

Figure 8.3 displays a similar pattern for the relationship between interorganizational performance and formalization. At low levels of formalization, chaos is likely to reign, whereas high levels of formalization are associated with rigidity (Luo, 2002; Mintzberg, 1994; Volberda, 1998). Basic levels of formalization form a precondition for people to engage in transactions (Dasgupta, 1988), making them willing to transact with external partners in the first place, and thereby expanding their set of options for value creation (Johnson et al., 2002; Malhotra and Murnighan, 2002). Irrespective of the level of trust, certain levels of formalization are necessary to endow participants in interorganizational relationships with guidance (Weick, 2001), and to enable them to coordinate their work (see Langfred, 2004). In this respect, Dyer and Chu (2003: 64) notice that ‘it seems that even for high-trusting relationships, it is necessary to spend some effort up-front to make sure that the responsibilities of each party are clearly spelled out.’ If this is impossible, economic actors might simply refuse to participate in interorganizational relationships (Bachmann, 2001).

FIGURE 8.3
Formal governance and interorganizational performance



Support for these assertions is provided by Hoecht (2004), who finds that legal control instruments such as detailed contracts were considered as normal “rules of the game” in the collaborative-private research projects that he investigated, and that they were not relaxed even if parties had a long cooperative history. Just like very low levels of formalization, excessively high levels of formalization are considered detrimental to interorganizational performance. They result in ‘cumbersome, overregulated, and impersonal processes that individuals are forced to adhere to’ (Beck and Kieser, 2003: 794). Excessive formalization of governance structures and monitoring of safeguards lead to conflict and disagreement among parties (Ring and Van de Ven, 1994). They have a retarding effect on creativity and innovation, and inhibit the flexibility that is needed for coping with complex, ambiguous and unstable task environments (Mintzberg, 1994; Nooteboom, 1999; Volberda, 1998). Excessive levels of formalization have further been argued to stifle desirable mutual accommodations (Ireland et al., 2002; Nooteboom, 1999), and to easily degenerate into formalism (Balogun and Johnson, 2004; Mintzberg, 1994; Starbuck, 1983). They may result in areas of unilateral dependence (Lusch and Brown, 1996; Macneil, 1980), hold-up problems (Klein et al., 1978), and high transaction costs (Williamson, 1985). Similar to trust, intermediate levels of formalization thus appear to be most conducive to interorganizational performance. We have captured these arguments in our first hypothesis.

Hypothesis 8.1: *Compared to very low and very high levels of trust and formalization, intermediate levels of both governance forms have a more positive influence on interorganizational performance.*

The relationships between trust, formalization and interorganizational performance that we have depicted here merit some qualification, as they are expected to be contingent on the nature of economic exchanges and on the legal regime in which these take place. Interorganizational relationships that deal with clear-cut issues and in which the focus is on standardization, routinization, and systematic cost reductions (Koza and Lewin, 1998; March, 1991; Rothaermel and Deeds, 2004), for example, generally do not require high trust environments. Conversely, in exploration contexts adequate specification of rights will inevitably be problematic (Oxley, 1997), and the scope of relationships cannot be clearly defined in advance, as tasks are non-routine in nature (Hoecht, 2004), performance is often ambiguous, and behaviors cannot be observed (Das and Teng, 2001; Dirks, 2000; Sitkin and Roth, 1993; Sitkin and Stickel, 1996). Although the trust-based mode of governance is probably also more risky in these situations, as difficulties to detect opportunistic behavior may increase a partner’s incentive to abuse trust (Carson et al., Forthcoming), it may provide the only option for leveraging the resources that are critical to competitive advantages (Bijlsma-Frankema, 2004; Bijlsma-Frankema and Koopman, 2004; McEvily et al., 2003b; Sitkin and Roth, 1993).

Trust is also argued to be more appropriate than formalization if partners are highly interdependent (Wicks et al., 1999), or when environments are volatile (Carson et al., Forthcoming). In a similar vein, different institutional environments

give rise to distinct relationships between trust and formalization (Deakin and Wilkinson, 1998). The institutional environment in Slovenia, for example, has been found to generate more trust than that in Bosnia. Consequently, actors from Bosnia tend to rely more on contracts (Rus and Iglič, 2005). Another example constitutes a comparison of the British and the German system. In the UK, written contractual agreements are frequently the result of exhaustive negotiations in which each party attempts to impose conditions upon the other, rendering contracts a signal of low trust. In Germany, instead, contracts are used to reassure partners of the common, or shared legal principles to which they adhere, thereby fostering trust (Bachmann, 2001). These examples indicate that the relationships between trust, formalization, and interorganizational performance that we have depicted here, are probably contingent on the nature of economic exchanges and on the legal regime in which these take place, something which strongly deserves to be addressed in future research (Bijlsma-Frankema and Costa, 2005).

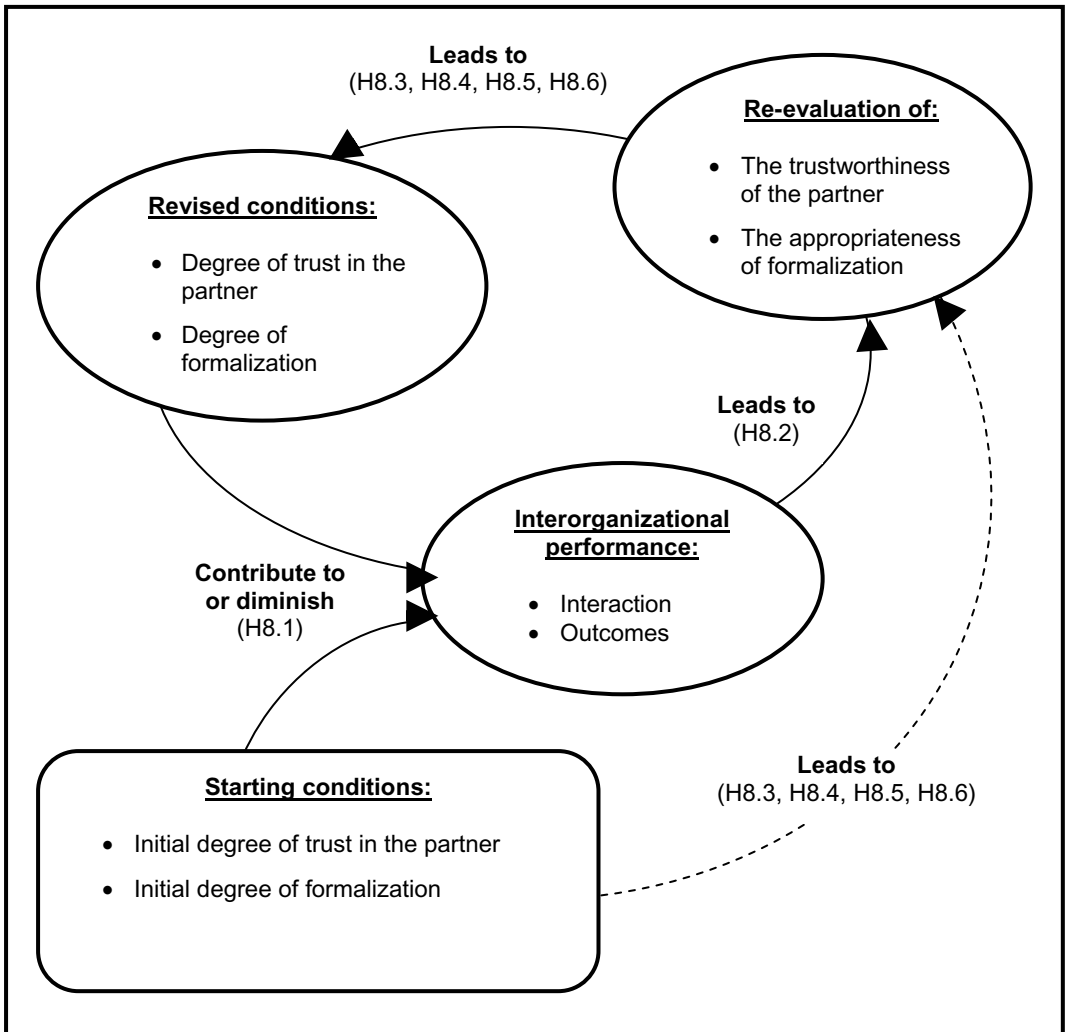
8.3 Towards a dynamic perspective: The evolution of trust, formalization, and interorganizational performance

Thus far, we have depicted a rather static image of the role of formalization and trust in interorganizational relationships. Building on our discussion in the first part of the chapter, Figure 8.4 presents a framework of the evolution of formalization and trust in interorganizational relationships. We start our explanation of the framework by noticing that interorganizational governance is not static (Bijlsma-Frankema and Costa, 2005). Relationships unfold and managers continually update their expectations and assessments of the levels of trust and formalization prevailing at a particular moment, while they also attempt to bring about desirable changes (Wicks et al., 1999). Following Doz (1996), Ferrin et al. (2005), Klein Woolthuis et al. (2005) and Ring et al. (2005), we will argue that starting conditions – here defined as initial levels of trust and formalization – leave strong imprints on the development of cooperative relationships. They influence the level of performance that is achieved in early stages of a relationship, and they shape managers' re-assessments of their partners' trustworthiness and of the appropriateness of formalization.

The influence of starting conditions on interorganizational performance

As we have seen in the first part of the chapter, trust and formalization are most conducive to interorganizational performance at intermediate levels. Starting conditions then influence the development of both governance forms in subsequent stages by their effect on interorganizational performance and each other. In particular, we suggest that in cases where interorganizational performance is relatively low – either in terms of achieved outcomes or in terms of the conduct of a partner – managers are more likely to experience a reduction in the perceived trustworthiness of their partner, as well as a higher willingness to increase the level of formalization.

FIGURE 8.4
A framework of the evolution of formalization and trust



This assertion derives from work on expectancy disconfirmation models, in which managers' perceptions of performance are believed to trigger a comparison of actual behavior and outcomes against managerial expectations (Oliver et al., 1994). When positive disconfirmation prevails, trust in the partner is reinvigorated, and the perceived need to formalize diminishes. In case of negative disconfirmation, trust in the partner declines and managers experience a relatively high propensity to act so as to reduce deviations between the performance actually achieved and their expectations. If trust and formalization have assumed

very low or very high levels in the beginning of a relationship, initial performance levels are therefore more likely to be low. Managers might then blame the partner, and accordingly perceive that their partner is less trustworthy (March and Olsen, 1975). They may also experience an urge to act, which translates itself into a heightened level of formalization (Sitkin and Bies, 1993). A low level of trust in the beginning may, for example, lead to quantitatively and qualitatively low levels of communication, which results in poor outcome performance and negative assessments of the interaction with a partner, possibly leading to even lower levels of trust in future (see also Ferrin et al., 2005). If we assume that low and high levels of trust and formalization in early stages of cooperation lead to relatively low levels of initial interorganizational performance compared to that for intermediate levels of both governance forms (hypothesis 8.1), then the following hypotheses hold (see also Figure 8.4).

Hypothesis 8.2a: *Compared to intermediate levels of trust and formalization, low and high levels of both governance forms reduce the perceived trustworthiness of a partner in subsequent stages of development.*

Hypothesis 8.2b: *Compared to intermediate levels of trust and formalization, low and high levels of both governance forms increase the perceived need for formalization in subsequent stages of development.*

Complementarity between trust and formalization

Starting conditions also influence the evolution of trust and formalization through complementarities in development, as an increase in the level of one of them may result in a higher level of the other (Dekker, 2004). In this respect, Poppo and Zenger (2002: 708) argue that 'well-specified contracts may actually promote more cooperative, long term, trusting exchange relationships.' Formalization may increase trust by providing people with objective rules and clear measures on which to base their assessments of others (Das and Teng, 1998; Sitkin, 1995). It may augment trust by increasing one's knowledge of another party's disposition, information, abilities, and available options (Dasgupta, 1988), and by narrowing down the domain and severity of risk (Poppo and Zenger, 2002). Formalization also facilitates trust building through ongoing discussions and negotiations, which allow partners to learn from, and about each other (Ring and Van de Ven, 1994), and to better understand each other's perspectives (Inkpen and Currall, 2004; Sitkin, 1995). Formalization further enhances trust by promoting information flows, and by spreading the costs of conflict, monitoring, and uncertainty (Deakin and Wilkinson, 1998; Malhotra and Murnighan, 2002; Sitkin, 1995). Finally, formalization minimizes implementation-related problems, and raises the reliability of the organization proposing the mechanisms (Sitkin and Roth, 1993). Child and Möllering (2003) therefore advance that the introduction of rules and standards can be depicted as a strategy for active trust development. Jointly, these observations indicate that formalizations provide interorganizational participants with predictability, reliability and security from which trust can develop (see Knights et al., 2001; Sitkin and Roth, 1993).

Similarly, higher levels of initial trust enable higher levels of formalization in subsequent stages. Trust not only serves as a precondition for partners to engage in the expensive and specific investments required to draft detailed contracts, but it is also needed to enable 'open communication and negotiations on the details of the contract, including the thorny sensitive clauses like relationship termination' (Klein Woolthuis et al., 2005: 831). Trust further facilitates high levels of information sharing (Dyer and Chu, 2003) and it drives the development of elaborate knowledge-sharing routines between partners (Dyer and Singh, 1998), thereby functioning as a 'lubricant of economic exchange' (Knights et al., 2001: 312). When low levels of trust prevail, instead, little information is exchanged between partners, reducing their ability to observe and learn about each other (Maguire et al., 2001), and diminishing their ability to capture aspects of the relationship in various forms of formalizations, such as contracts, rules and procedures. Accordingly, we propose the following (see also Figure 8.4).

Hypothesis 8.3a: *Higher levels of trust facilitate a focal manager's ability to formalize aspects of the relationship in subsequent stages of development.*

Hypothesis 8.3b: *Higher levels of formalization increase a focal manager's ability to rely on trust in a partner in subsequent stages of development.*

Substitution of trust, formalization, and expected net benefits

Trust and formalization can also act as substitutes. After all, they consist of 'functionally equivalent strategies for absorbing uncertainty and dealing with the freedom and indeterminacy of other agents' (Knights et al., 2001: 329; see also Reed, 2001). From a substitution perspective, both governance forms entail a reduction of uncertainty and complexity, while they increase the perceived predictability of social actors' future behaviors (Luhmann, 1979; Nootboom, 2002). In other words, trust and formalization are considered as alternate routes for arriving at stable orders to which social actors can orient their behavior (Layder, 1997). When partners lose their trust in each other, procedures will become more formal and they need to invest more resources to monitor the other party's actions and to enforce contracts (Dyer and Chu, 2003; Inkpen and Currall, 2004). In these cases, collaboration requires more effort and processes assume an emergent or even engineered instead of an embedded character (Ring et al., 2005). High levels of trust, instead, render formalization redundant, as the behavior of partners is already perceived as being predictable. In these cases, the presence of trust may reduce managers' inclination to apply formalization to guard against opportunistic behavior (Inkpen and Currall, 2004; Zaheer et al., 1998). In a similar vein, high performance expectations can substitute for both trust and formalization. Managers may initiate and maintain relationships with others, even when trust in the partner is absent and formalization cannot be established, as long as they expect that the net benefits of a relationship exceeds the potential losses (Parkhe and Miller, 2000; Ring et al., 2005). An example consists of the KLM-Northwest Airlines alliance in 1995 and 1996. These firms jointly exploited their ability to coordinate pricing and scheduling for many years. Although their relationship was characterized by boardroom fights, distrust, discord, and

accusations of infidelity, the relationship was sustained as it resulted in hundreds of millions of dollars in profits for both firms (Maler, 1997). This leads us to the following hypotheses (see also Figure 8.4).

Hypothesis 8.4a: *Higher levels of trust reduce a focal manager's need to formalize aspects of the relationship in subsequent stages of development.*

Hypothesis 8.4b: *Higher levels of formalization reduce a focal manager's need to trust a partner in subsequent stages of development.*

Hypothesis 8.4c: *Higher expectations of net benefits increase the likelihood that partners remain involved in a relationship in subsequent stages of development, even if levels of trust and levels of formalization are low.*

The influence of trust on re-assessments of trust

In this section, we argue that initial expectations of a partner's trustworthiness have a strong impact on the evolution of trust and formalization, as initial expectations affect the inferences that we make later on (March and Olsen, 1975; Weick, 1995). Managers make sense of acts of formalization by their partners in ways that minimize the discrepancies between their expectations and their observations, so as to experience stable and predictable impressions of their interaction partners. Congruent with work from Kahneman and Tversky (1973), a partner's behavior is likely to be interpreted such as to reinforce preconceptions of its trustworthiness (March and Olsen, 1975). Consequently, initial levels of trust strongly influence whether formalization by the partner results in a spiral of decreasing trust, defensive behavior, conflict, and increased emphasis on monitoring and control (Ghoshal and Moran, 1996), or whether formalization is interpreted as a signal of commitment and as an expression of trust in the partner organization (Klein Woolthuis et al., 2005). Low expectations of trustworthiness, for example, may lead potential trustors to interpret the behavior of others and the initial outcomes achieved in a relationship in a less favorable light than would be the case if levels of trust were high (Kramer, 1994). When levels of trust are already low, attempts to formalize convey a sense of even lower trust, because it suggests that partners' goodwill or competences are thrown into doubt (Das and Teng, 1998, 2001). The way in which trust develops, may then resemble a kind of self-fulfilling prophecy in which initial expectations influence subsequent trust building (Adobor, 2005). This implies that it becomes very difficult to build trust through experience in some cases, as low levels of trust may either initially prevent people from engaging in collaboration, or because it leads to behaviors that further reduce trust. Gambetta (1988: 234) therefore remarks that once trust decreases, 'it soon becomes impossible to know if it was ever in fact justified, for it [i.e. trust] has the capacity to be self-fulfilling.'

These assertions are congruent with Zand's (1972) spiral reinforcement model, in which particular levels of trust are reinforced over time. The model suggests that when participants in interorganizational relationships encounter low levels of trust, they will hesitate to reveal information, reject influence, and evade control. 'This

short cycle feedback will reinforce the originator's low trust' (Zand, 1972: 230) and cause partners to fall into spirals of suspicion (Anderson and Jap, 2005). In such cases, increases in formalization that are intended to restore trust across organizational boundaries are perceived as being signals of low trust (Bernheim and Winston, 1998; Ghoshal and Moran, 1996; Jap and Ganesan, 2000; Poppo and Zenger, 2002; Sitkin and Roth, 1993). An increase in formalization may then introduce a sense of distance and differentness between partners, alienating them from each other, and inducing suspicion and undermining commitment (Avadikyan, 2001; Hoecht, 2004; Liebeskind and Oliver, 1998; Sitkin and Stickel, 1996). Such reactions were evident, for example, in a longitudinal study of interorganizational relationships by Van de Ven and Walker (1984) who found that excessive formalization and monitoring led to conflict and reduced trust among cooperating parties.

In such cases, formalization does not contribute to safeguarding a relationship, but it becomes destructive, undermining the development of trust (e.g. Lewicki et al., 1998; Sitkin and Roth, 1993). It discourages partners from contributing to a relationship, and provokes human fights and aversions to change (Bijlsma-Frankema, 2004). In such cases, formalization gives rise to a low trust atmosphere, which is frequently reciprocated with even more formal constraints, possibly eventuating in a relation that is locked-up in formalities (Nooteboom, 1999; Parkhe, 1993). Congruent with these arguments, Sitkin and Roth (1993: 367) contend that the application of contracts, bureaucratic procedures, or legal requirements, can lead to an "inflationary spiral" of increasingly formalized relationships. They argue that, due to the imposition of psychological and interactional barriers and owing to thwarted efforts to achieve congruent values, a need for more contracts, rules and procedures develops (Sitkin and Roth, 1993), possibly resulting in a self-fulfilling prophecy (Macaulay, 1963; McEvily et al., 2003b). Van Marrewijk (2004) offers an example in his analysis of Unisource, an alliance of Swedish Telia, Dutch KPN Telecom, Swiss Telecom, and Spanish Telefónica. He clarifies that as trust did not develop, the partners turned to more formalization mechanisms. This slowed down decision-making processes, diminished the competitiveness of the alliance, and further deteriorated trust and commitment. Anderson and Jap (2005) also reveal that a significant portion of the more than 200 industrial partnerships they studied exhibit the forming of dysfunctional spirals of suspicion.

Conversely, when participants in interorganizational relationships initially experience high levels of trust in a partner, which is frequently the case in new cooperative endeavors (Ferrin et al., 2005), attempts to increase the level of formalization may be regarded as a symbol of the sharing of values and an articulation of communal norms and customs (Zucker, 1988). Each party then presumes that the other party is acting in good faith and both will interpret behaviors more positively (Adobor, 2005; Uzzi, 1997). In these situations, the willingness to formalize, signals commitment to a partner (Klein Woolthuis et al., 2005). It indicates that parties care about the relationship and that they intend to put efforts in achieving the objectives that were set for the relationship (Serva et

al., 2005). The higher levels of trust that ensue, enable parties to capture other aspects of the relationship in formalizations (Mayer and Argyres, 2004; Poppo and Zenger, 2002). In such cases, higher levels of formalization contribute to the development of trust, which subsequently opens up new possibilities for applying formalizations. This leads us to the following hypothesis (see also Figure 8.4).

Hypothesis 8.5: *Higher levels of trust entail more positive interpretations of a partner's attempts to formalize, increasing the likelihood that trust is further reinforced in subsequent stages of development. Conversely, lower levels of trust involve more negative interpretations of a partner's attempts to formalize, increasing the likelihood that trust deteriorates in subsequent stages of development.*

The influence of formalization on re-assessments of trust

We also propose that higher levels of formalization in the beginning of a relationship make a partner's trustworthiness easier to assess. Formalization helps to clearly define the roles and responsibilities of partners and it assist in creating shared expectations (Mayer and Argyres, 2004). It thereby facilitates the assessment of a partner's behavior and of its contributions to the outcomes that have been accomplished in a relationship (Carson et al., Forthcoming), but also broadens the domain of expectations that can be violated by one of the partners in a relationship (Malhotra and Murnighan, 2002). In contrast, when formalization is initially low, much room is left for widely different perceptions and frames against which meaning is made. Such a situation occurred in an alliance between Ciba Geigy and Alza, where the absence of reasonably detailed contractual agreements led to 'growing suspicions and tensions as each partner was searching for clues in the behavior of the other' (Doz, 1996: 68). The lack of a clear agreement made it hard for these partners to assess each other's trustworthiness. Finally, we maintain that if formalization is high in early stages of cooperation, a partner's ability to extend trust beyond initial levels becomes low. After all, trust can only develop when parties have an opportunity to refrain from cooperation (Inkpen and Currall, 2004). When initial levels of formalization are high, partners experience limited autonomy in shaping their behavior, which makes it more difficult for them to demonstrate their goodwill and/or competence, leaving them with fewer opportunities to develop trust (Doz, 1996; Malhotra and Murnighan, 2002). This is reinforced by the fact that the imposition of formalizations may provoke negative feelings and opportunistic behavior, something which calls for even more formalization, and which further diminishes trust (Ghoshal and Moran, 1996). These assertions lead us to our final hypothesis (see also Figure 8.4).

Hypothesis 8.6a: *Higher levels of formalization facilitate the assessment of the trustworthiness of a partner in subsequent stages of development.*

Hypothesis 8.6b: *Higher levels of formalization complicate the extension of trust beyond the level prevailing in the beginning of a relationship.*

8.4 Discussion

In this conceptual chapter, we developed an integrative perspective on the evolution of trust and formalization in interorganizational relationships. To arrive at such a perspective, we first elaborated on the influence of trust and formalization on interorganizational performance. In the second part of the chapter, we introduced dynamics and we argued that trust and formalization tend to develop along self-reinforcing paths. Building on the work of other researchers (Doz, 1996; Ferrin et al., 2005; Klein Woolthuis et al., 2005), we indicated that starting conditions – being the levels of trust and formalization in early stages of cooperation – have a significant impact on the development of both governance modes and of interorganizational performance in later stages of development. Our assertions were captured in tentative propositions and in an integrative conceptual framework, which reconciles hitherto fragmented views on the evolution of trust and formalization in interorganizational relationships.

These arguments have significant implications. They show academics that mono-causal explanations for observations on both governance forms provide incomplete accounts of reality (see also Bachmann, 1998), and that an integrative approach has to be taken to fully understand the evolution of trust and formalization in interorganizational relationships. After all, different levels of trust, formalization, and performance appear to be intricately related, which renders conceptualizations of governance in which trust and formalization vary independently inappropriate (see also Möllering, 2005). Our arguments also indicate that it is interorganizational performance that matters and that neither trust nor formalization should become ends in themselves. High levels of trust or formalization have sometimes been depicted as ideal states, but we have shown that rigidity and naiveté lure around the corner, and that intermediate levels of both governance forms are probably most conducive to performance. Therefore, inquiries into the factors influencing trust and formalization should be accompanied by assessments of interorganizational performance. Third, we have argued that starting conditions – being the levels of trust and formalization in early stages of cooperation – strongly influence how interorganizational relationships evolve. Our model supports Doz's (1996: 77) argument that early "small" events and initial conditions characterizing interorganizational cooperation 'have a disproportionate importance in establishing, or not, a self-reinforcing cycle of [...] trust and commitment.' This raises several points.

First, it suggests that organizations might be better off when they decide to refrain from interorganizational cooperation in cases where starting conditions are unfavorable. They may also benefit from breaking off relationships characterized by negative self-reinforcements in earlier stages. Although this may seem obvious, we wish to emphasize it here, because many relationships persist although prospects are bad (Inkpen and Ross, 2001). We suggest that this may partly derive from the fact that partners do not recognize the significant impact of starting conditions on the development of interorganizational relationships, believing that they are able to counter self-reinforcing developments, even if they are not.

Second, although our description suggests that similar starting conditions lead to similar outcomes, they may cause divergent reactions by partners, due to differences in interpretation between managers (March and Olsen, 1975). Interpretation processes are fraught with potential missteps and errors as well as systematic biases, so that the same starting conditions may lead to different performance outcomes for comparable relationships. The development of trust is contingent, for example, on the ability of trading partners to “read” each other, and on their ability to “signal” trustworthiness (Carson et al., 2003). The latter suggests that the ambiguity surrounding the intentions that partners have with formalizations and their ability to communicate those intentions should receive more attention from researchers and practitioners (see also Carson et al., Forthcoming; Klein Woolthuis et al., 2005; Serva et al., 2005). Practitioners have to realize, for instance, that acts of formalization by their partners do not necessarily imply that they are not trusted. To prevent misunderstandings from occurring, they can inquire into each others’ reasoning behind acts of formalization, or they may explain their own acts more clearly to partners.

Several avenues for further research can be identified. First, we developed a framework in which different actors react similarly when being confronted with certain levels of and changes in trust, formalization, and performance. Research by Ferrin et al. (2005) and Serva et al. (2005) indicates that this approach may be further refined by distinguishing the actions and reactions from one party from those of another party, so that the reciprocal nature of trust-building becomes illuminated. Although we believe the dynamics depicted in our framework would remain intact, incorporating actions and reaction of multiple parties could offer better insights into the extent to which starting conditions influence the evolution of the relationship. This would lead to a double-loop model, in which trust-expectations and acts of formalization by one party influence the development of trust and acts of formalization by another party. Second, more attention could be paid to the negative aspects or dysfunctions of trust, and the positive aspects or functions of formalization, so that a more balanced perspective on these governance forms develops. Positive sentiments surrounding most research on trust (Dirks and Ferrin, 2001) and the negative connotation that some people have with formalization (Beck and Kieser, 2003) may be replaced by images of both concepts that are closer to reality. A third promising research direction could be to investigate the extent to which our model is contingent on exchange characteristics and on the institutional contexts in which relationships are embedded. Little systematic attention has been paid to such factors, although they may explain a relatively large share of the variance in trust and control (Bijlsma-Frankema and Costa, 2005). Sitkin and Stickel (1996), for example, have revealed that the level of formalization should match with the nature of the task performed, to prevent escalating cycles of trust deterioration from developing. Finally, research efforts could focus on the interventions that managers undertake to make sure that trust and formalization do not degrade or escalate beyond appropriate levels. Insights in how self-reinforcing cycles can be broken, and how trust can be repaired could further advance our understanding of the evolution of trust and formalization in interorganizational relationships.

9 THEME 6 – GOVERNANCE TRAJECTORIES

'Despite a clarion call for further examination of multiple control mechanisms, few empirical studies have investigated this issue.'

Jap and Ganesan, 2000: 227-245

Summary

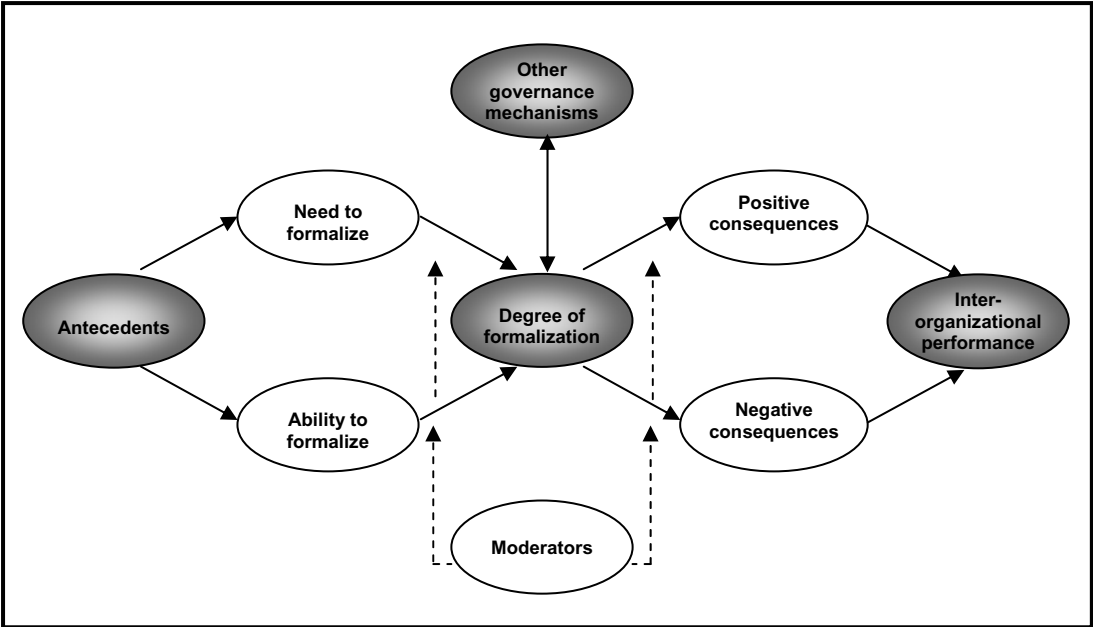
Interorganizational governance efforts – attempts to coordinate and control activities and outcomes in external collaborative ventures – are composed of multiple, interrelated decisions that are taken over a relationship's life cycle. Notwithstanding this multi-dimensionality, academic studies on interorganizational governance frequently pertain to only one or a few governance choices. Little attention is paid to the interrelationships between governance choices, and to the dynamics characterizing value creation and value claiming activities in interorganizational relationships. We challenge this deficiency by conceptualizing interrelated governance decisions made during different stages of a collaborative relationship as "governance trajectories". We propose that the decisions embedded in these trajectories possess dissimilar organization-level and relational-level antecedents, and that decisions made in earlier stages of cooperation affect decisions made later on. Analyses of six governance decisions for a sample of 911 buyer-supplier relationships support our arguments. By challenging the conventional focus on singular governance decisions, and by replacing it with the concept of governance trajectories, the chapter contributes to a more comprehensive and dynamic picture of interorganizational governance.

9.1 Introduction

Interorganizational relationships are believed to consist of several stages, including a search and selection phase, a negotiation phase, and a contracting phase (see Buskens, et al., 2003a; Jap and Ganesan, 2000; Reuer, 1999, 2000; Zollo and Singh, 2004). These three stages in an interorganizational relationship's life-cycle (see De Rond, 2003; Jap and Ganesan, 2000) correspond with different governance decisions aimed at the coordination and control of interorganizational activities and outcomes. Despite the distinction between these three stages, studies on series of successive governance decisions are still rare in the literature (Anderson and Dekker, 2006; Long et al., 2002; Narayandas and Rangan, 2004). In particular, most of the research on exchanges between organizations treats them as discrete events instead of as mechanisms for managing ongoing relationships (Dwyer et al., 1987). Moreover, 'there has been little work that examines the simultaneous use of multiple mechanisms to structure exchange relationships' (Jap and Ganesan, 2000: 228; see also Lusch and Brown, 1996). Research on interorganizational governance is generally centered on static typologies, paying little attention to the origins and evolution of interorganizational governance (Cardinal et al., 2004; Narayandas and Rangan, 2004). This is due, among others, to the precedence that has been given to analytical precision and theoretical rigor over rich descriptions of reality (Zollo and Singh, 2004). It also

derives from researchers' attempts to determine single best controls (Long et al., 2002), and the presumption that one mechanism should be used over another depending upon a given activity or context (Cardinal, 2001; Eisenhardt, 1985; Ghoshal and Moran, 1996; Ouchi, 1979). Such an "overly rational conceptualization" of managerial attention and action only leads to correct conclusions when single governance decisions are compared (Long et al., 2002). It does not take into account that managers use distinct governance mechanisms to accomplish the same function (Bradach and Eccles, 1989; Miller et al., 2004), and that they have to address a complex array of organizational functions and contingencies (Cardinal, 2001; Cyert and March, 1963; Kirsch, 1997; Long et al., 2002). It also remains agnostic to the fact that different governance mechanisms may complement or substitute one another (Anderson and Dekker, 2006). The resulting gaps in our understanding of interorganizational governance are significant, given that governance systems are widely acknowledged to be ubiquitous and critical to the functioning of organizations and interorganizational relationships (Buskens et al., 2003a; Cardinal, 2001; Cardinal et al., 2004; Cyert and March, 1963; Reuer and Ariño, 2003; Ring, 2002). To address this issue, we focus on the following research question: To what extent are decisions on formalization related to other governance decisions? This question concerns the areas that have been shaded in the research framework depicted in Figure 9.1.

FIGURE 9.1
Research framework – theme six



To investigate this question, we propose the concept of “governance trajectories”, which we define as sequences of interrelated decisions that are made to control, direct, or influence the actions and conduct of participants in interorganizational relationships during successive stages of an interorganizational life-cycle. Adoption of the life-cycle concept underscores the importance of distinct phases of collaboration as elements of value creation (Reuer and Zollo, 2000: 171). Examining how organizations govern collaborative relationships during multiple stages of cooperation offers a broader, more realistic perspective on interorganizational governance (Cardinal, 2001; Narayandas and Rangan, 2004). We recognize that it is virtually impossible to conduct an exhaustive study of interorganizational governance arrangements, because organizations have a large number of potential governance mechanisms at their disposal (Heide and John, 1990). However, a review of the literature suggests that interorganizational governance trajectories at least comprise decisions with respect to:

- (1) The type of partner selected (e.g. Gulati, 1995; Ryall and Sampson, 2004);
- (2) Exhaustiveness of selection efforts (e.g. Luo, 1997; Nielsen, 2003);
- (3) Advance payments (e.g. Helm and Kloyer, 2004);
- (4) Exhaustiveness of negotiations (e.g. Ariño and Ring, 2004; Korobkin, 2000);
- (5) Use of standard contracts (e.g. Epstein, 1999; Korobkin, 2003), and;
- (6) Completeness of the contract (e.g. Luo, 2002; Poppo and Zenger, 2002).

By means of binary logistic regressions and multiple regression analyses on a sample of 911 buyer-supplier relationships, we demonstrate that each of these governance decisions can be explained by disparate sets of explanatory variables, and we describe the interrelationships between various governance decisions. In doing so, the chapter contributes to the interorganizational governance literature in several ways. Although other studies have begun to examine combinations or portfolios of control modes (Kirsch, 1997), our research is one of the first endeavors to explore sequences of interrelated governance decisions made during successive stages of an interorganizational life cycle (other examples are Heide (2003) and Wathne and Heide (2004)). By proposing the concept of governance trajectories, we move the analytic focus from the application of singular governance mechanisms, towards series of governance decisions. The chapter thereby differs from earlier governance analyses with the same or similar data in which either single governance decisions were studied (see Buskens, 2000), or in which interorganizational governance was measured by additive measures capturing multiple governance decisions at once (Batenburg et al., 2003). Besides, the chapter diverts the primary focus in governance research from studying contracts to inquiries into other means of coordination and control. Interorganizational relationships are thereby portrayed as organizational forms that – either simultaneously or over time – operate distinct governance mechanisms for similar (Bradach and Eccles, 1989), or different functions (Avadikyan et al., 2001). Although examinations of contract completeness have proliferated (Masten and Saussier, 2002), inquiries into other governance decisions, such as those concerning advance payment of suppliers, or the use of standard-form contracts, are much scarcer. Similarly, limited research efforts have been devoted to partner

search and selection processes (e.g. Blumberg, 2001; Buskens et al., 2003b; Hitt et al., 2000), despite their influence on the mix of skills and resources available to interorganizational relationships (Geringer, 1991), and organizations' apparent quests for a suitable partner. Finally, our research renders empirical support for the assumption that governance decisions are intricately related to each other, and that governance decisions made early on in a relationship influence successive decisions.

The chapter is organized as follows. First, we propose the concept of governance trajectories. We argue that governance decisions embedded in these trajectories have disparate antecedents, and that they possess significant interrelationships with each other. To test our assertions, we subsequently analyze 911 buyer-supplier relationships in the Netherlands involving IT-suppliers and small- and medium-sized buyers. We conclude with a summary of the major findings.

9.2 Theory on interorganizational governance decisions

Organizations govern their interorganizational relationship by directing the behavior and performance of participants in interorganizational relationships towards the production of actions desirable to the relationship or to themselves. They attempt to restrict the occurrence of problems arising from goal divergence and asymmetrical objectives (Buskens et al., 2003a; Doz, 1996; Ireland et al., 2002; Kale et al., 2000), by pursuing partial control over a partner's resources and behavior (Blumberg, 2001), and by limiting their potential for opportunistic behavior (Williamson, 1985). Besides, governance efforts may be directed towards minimizing coordination costs resulting from the complexity and uncertainty involved in managing a cooperative relationship (Park and Ungson, 2001), and at reducing the variability in partners' expectations about the value that can be created in the relationship (Inkpen and Beamish, 1997). In other words, governance efforts in interorganizational relationships are both aimed at control and coordination. They contemporaneously affect value creation and value appropriation (Gulati and Singh, 1998; Gulati and Wang, 2003; Heiman and Nickerson, 2004).

Hitherto, most governance research has devoted attention to contracting practices. However, Heide and John (1990) have demonstrated that governance can be accomplished in a more discriminating way, and that different mechanisms are available that are more or less sensitive to the specific problems at hand. Several governance mechanisms have been proposed to help circumvent, mitigate, or alleviate coordination and control problems. These include, among others, exhaustive partner selection efforts (Ireland et al., 2002), equity exchange between partners (Oxley, 1997), and partner negotiations (Adair and Brett, 2005; Ariño and Ring, 2004). In fact, organizations implement a variety of mechanisms or processes to ensure that tasks are conducted in a way that is consistent with organizational goals (Heide, 1994; Kirsch, 1997). The assumption prevails that these and other governance mechanisms are related to each other. In this regard, Klein (2002: 62), for instance, pointed out that 'Increased contractual specification

involves rent-dissipating search and negotiation costs.' Others suggest that multiple governance mechanisms, including the selection of appropriate partners and alliance designs, jointly warrant value creation in interorganizational relationships (Reuer, 1999).

However, not every governance mechanism may serve coordination and control in the same way. Whereas partner selection efforts may be primarily directed at selecting a partner with appropriate knowledge and capabilities, drafting a contract might be predominantly involved in the mitigation of opportunistic behavior of a partner. Moreover, it has been noticed that different governance mechanisms are used to facilitate coordination and control during successive stages in interorganizational relationships. In her study of information systems development projects, for example, Kirsch (1997) ascertains that stakeholders implement a portfolio of control modes containing a mix of overlapping and redundant mechanisms. By deploying multiple governance mechanisms, managers develop competencies across an entire collaborative process, which makes them better equipped to capitalize on a wide array of opportunities for achieving efficiency and effectiveness during an entire relationship (Cardinal et al., 2004; Simons, 1995). These assertions have led scholars to argue that research efforts should be redirected from examining singular forms of governance to evaluating more complex governance systems (Long et al., 2002). Although research has been conducted into possible links between formal governance, prior experience, and trust (see for instance Gulati, 1995; Luo, 2002; Poppo and Zenger, 2002), and on relationships between partner selection criteria and other governance decisions (Nielsen, 2003), inquiries into larger series of governance decisions have remained absent in the literature up until now. In this chapter, we adopt the life-cycle metaphor of strategic alliances (De Rond, 2003; Reuer, 2000; Van de Ven, 1992) as a means to develop a more dynamic and integrative perspective on interorganizational governance.

9.3 Sequences of governance decisions

Congruent with descriptions of interorganizational development along the life-cycle of an interorganizational relationship, we propose that various governance efforts are embedded in governance trajectories. We define these trajectories as *sequences of interrelated decisions that are made to control, direct, or influence the actions and conduct of participants in interorganizational relationships during successive stages of an interorganizational life cycle*. We discern three cooperative stages in which governance efforts are known to be ubiquitous, including a partner selection stage, a negotiation stage, and a contracting stage. Each stage entails at least two decisions. During the partner selection stage, for example, decisions are made on the selection of a familiar or an unfamiliar partner, and on the exhaustiveness of partner selection efforts. In the negotiation stage, decisions pertain to advance payments of suppliers or other partners and to the exhaustiveness of negotiations. Finally, in the contracting stage, collaborating parties decide whether to use standard-form contracts or not, and they determine how complete contracts should be, both forming decisions on formalization. The

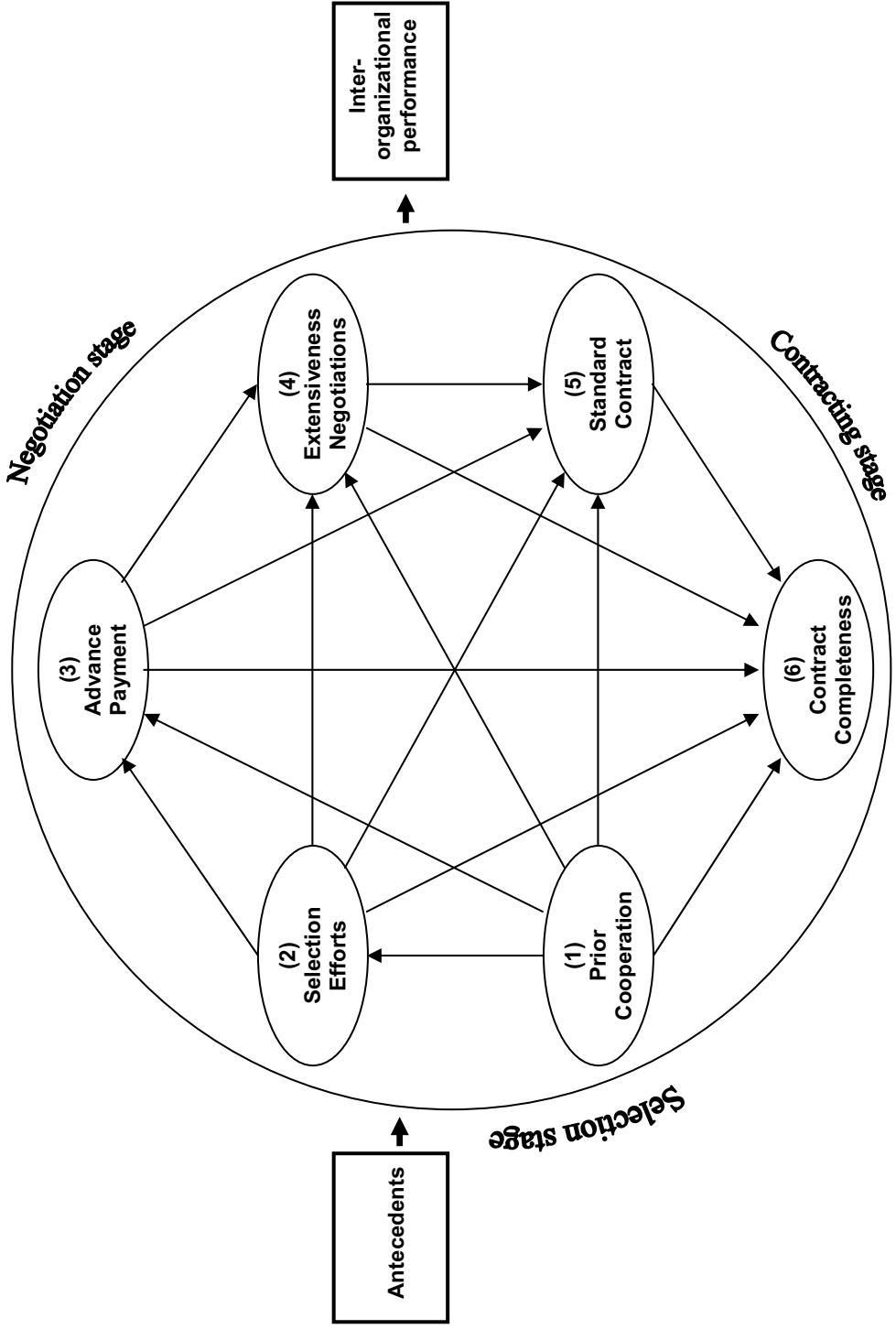
six governance decisions distinguished depend on different sets of antecedents and on preceding governance decisions. In light of recent debates on the factors determining relationship efficiency and effectiveness (Colombo, 2003; Heiman and Nickerson, 2004; Koza and Lewin, 1998; Madhok, 2002; Oxley, 1997; Reuer and Zollo, 2005; Takeishi, 2001), we include both firm-level and transaction- or relational level factors as explanatory variables of governance choices. In Figure 9.2., we depict the three governance stages, the decisions associated with them, and their relationship with antecedents and interorganizational performance in an integrative conceptual framework. Consonant with life-cycle theories, we pay attention to the starting conditions, functional end-points, and the processes of change between them (Van de Ven, 1992). We briefly elaborate on each governance stage and the decisions associated with it here, starting with the partner selection stage.

Partner Selection Stage

After an organization has made the decision to engage in an interorganizational relationship, the selection of an appropriate partner is the next critical event (Hitt et al., 2000). Partner selection refers to acts involved in identifying potential exchange partners and assessing their quality and intentions (Buskens et al., 2003; Gulati, 1995; Rangan, 2000). The general purpose served by partner selection is to 'proactively solving potential governance problems' (Wathne and Heide, 2004: 75). Partner selection is crucial to interorganizational performance as it affects the complementarity of allying firms and their combination of strengths and weaknesses (Doz and Hamel, 1998). Partner selection primarily entails two governance decisions. First, a focal organization has to decide whether it is desirable and possible to work with a familiar partner or not. Second, a decision has to be made as to the amount of effort that is invested in selecting a partner (Buskens et al., 2003). Concerning the first decision, it is recognized that organizations show a propensity to initiate interorganizational relationships with partners with which they have previously cooperated (Gulati, 1995; Gulati and Gargiulo, 1999; Kale et al., 2002). Cooperation with familiar partners is generally preferred above cooperation with organizations that are less well known to the focal organization, as partners that have previously cooperated have had the opportunity to build up interorganizational trust and a good reputation (Gulati, 1995; Macaulay, 1963). Prior relationships simply serve as repositories for information on a partner. They reduce the focal organization's uncertainty about a partner's intentions, interests, reliability, resources, and capabilities (Gulati and Gargiulo, 1999; Li and Rowley, 2002; Rangan, 2000; Saxton, 1997). Focal organizations can, for example, 'make vicarious inferences' about likely behavior of their partners in new collaborative ventures by extrapolating past records into the future³² (Parkhe, 1998: 421).

³² Batenburg et al. (2003: 170) found support for the significance of the evaluation of previous exchanges with familiar partners for partner selection in novel transactions. In the same data-set as the one that is being used in this study, they found that hardly any of the cases in the data consists of business partners with a negative shared past. This suggests that searching for another partner is the most likely response to a problematic transaction.

FIGURE 9.2
Integrative conceptual framework on governance trajectories: antecedents, governance decisions, and interorganizational performance



In line with this, Hoetker (2005) promulgated that organizations particularly opt for cooperation with familiar partners when moderate levels of uncertainty apply. Moreover, familiar partners frequently intent to maintain a profitable relationship during long time horizons, which reduces their scope for opportunistic behavior (Lui and Ngo, 2004; Madhok, 1995; Palay, 1996; Ryall and Sampson, 2004). Besides, organizations are known to select familiar partners routinely, without engaging in exhaustive evaluation processes (Li and Rowley, 2002), as there are more certain rewards for exploiting existing relationships opposed to developing new relationships (March, 1991). The decision to select a familiar partner helps these organizations to circumvent the evaluation of potential partners with unknown characteristics and less predictable behavior (Li and Rowley, 2002), and it prevents these organizations from selecting partners based on technical criteria (Hoetker, 2005). Finally, although the motives or inducements for selecting a familiar partner might be obvious, organization- and relational characteristics can prohibit the selection of a familiar partner. The opportunities for selecting familiar partner may be restricted and opportunities to collaborate in general are not equally available to all organizations (Ahuja, 2000). Focal organizations, for example, might not have had prior relationships in a certain business area. We therefore conceptualize the selection of a familiar or an unfamiliar partner as an explicit governance decision, which is influenced by several relation- and organization-level characteristics.

The second governance decision in the partner selection stage concerns the extent to which search and selection efforts are employed for assessing whether an organization would be an appropriate partner for a particular cooperative endeavor. Although the efforts put in partner selection comprise a distinct decision in the alliance formation process (Geringer, 1991; Nielsen, 2003), analysis of search and selection efforts has been a rather neglected topic in the interorganizational governance literature (Blumberg 2001; Nielsen, 2003). Search and selection efforts have only recently attracted systematic attention in the theoretical and empirical literature on interorganizational network formation and dynamics (Buskens et al., 2003b). Despite a lack of clarity and insufficient solid empirical evidence, researchers have maintained that partner selection is a major variable in the formation and operation of interorganizational relationships (Blumberg, 2001; Buskens et al., 2003b; Gulati and Gargiulo, 1999; Nielsen, 2003). It reputedly assist in assessing the overall viability of interorganizational relationships (Geringer, 1991), and to reduce the occurrence of problems and conflicts of interests that stem from cultural, organizational, resource, and strategic misfits (e.g. see Barkema and Vermeulen, 1997; Lane and Lubatkin, 1998; Luo, 1997). In his analysis of 116 international joint ventures, for example, Luo (1997) revealed that partner selection influenced financial returns, local market expansion, export growth, risk reduction, and overall performance³³.

³³ One should not forget that, similar to formalization, search and selection efforts both have positive and negative effects on interorganizational performance. Beyond some level, the accumulation of more information and the expenditure of more time on deliberation can involve costs that offset advantages, and so diminish profits (Furobotn, 2002: 92).

Negotiation stage

This stage typically encompasses activities concerned with relational positioning, identification of the problem that has to be solved, generation of solutions, and reaching of agreement (Adair and Brett, 2005). During negotiations, proposals for cooperation are exchanged between partners (Putnam, 2003), and participants in interorganizational relationships work towards agreement on key issues of the relationship. During this stage, organizations have to at least make decisions on whether a supplier or another partner has to be paid in advance, and on what the appropriate length or exhaustiveness of negotiations with a partner should be. With respect to the first decision, we note that equity exchange between partners has received abundant attention. In particular, the alliance literature is infested with articles on the choice between equity and non-equity relationships (see Gulati and Singh, 1998; Oxley, 1997). However, other types of cooperation, such as buyer-supplier relationships, also entail decisions on equity transfer. Buyers and suppliers jointly decide whether advance payments for products and services are made. Advance or up-front payments minimize the risk of hold-up experienced by a supplier (Helm and Kloyer, 2004). When higher risks are anticipated, advance payment becomes more probable. Therefore, advance payment is likely to be dependent on factors such as the financial volume associated with a transaction and the financial strength of both parties. Advance payments may subsequently influence successive governance decisions, as they pose additional risks for buyers, aggravating their dependence on suppliers.

Next to advance payments, this stage is reminiscent of a focus on formal bargaining processes surrounding the logic of a business proposal (Ariño and Ring, 2004). Bargaining is defined as the process whereby in the face of resistance parties rearrange their mutual distributions of obligations, benefits, and burdens (Dwyer et al., 1987: 16). The extent of these negotiations is conceptually different from search and selection efforts and from contractual issues. Search and selection efforts, for example, might improve one's ability to negotiate, whereas partners might not be able to lay down issues that are fiercely negotiated, due to bounded rationality and the existence of a plethora of unforeseen contingencies. Furthermore, they might be reluctant to lay down certain outcomes of their negotiations, as these might lead to hold-up problems (see Klein, 2002) or high transaction costs (Williamson, 1985). The extent of negotiations thus forms a separate means to coordinate and control in interorganizational relationships.

Contracting stage

In the contracting stage, parties have to make decisions on formalization. In particular, parties have to choose whether standard contracts are being applied and how complete contracts have to be. On the one hand, standard contracts lower the efforts required to specify or compose contracts, and they enable fast interaction with a broad range of partners. Furthermore, the clarity of terms in standard contracts can reduce the strain on interpretive practices, and minimize the risk of inconsistent interpretations of contract clauses (Epstein, 1999). On the other hand, standard contracts have been argued to preclude active buyer involvement and flexibility. They are reputed to reflect the contract-issuing

organizations' requirements, possibly leading to dissatisfaction on the part of partners. Standard contracts between hardware or software suppliers and buyers, for instance, usually benefit suppliers (e.g. Asner, 1983; Nevers, 1987). In general, standard contracts initiated by suppliers merit scrutiny, as buyers are boundedly rational, and mainly consider contracting terms that are salient when relationships commence. Besides, buyers often fail to read the terms in standard form contracts, as the usual content of standard contract terms makes them unlikely to attract a buyer's attention, and because search and deliberation costs, which are necessary to understand the contract terms, are high (Eisenberg, 1995). This endows suppliers with the 'incentive to draft non-salient contract terms to their own advantage' (Korobkin, 2003: 1207). The foregoing assertions indicate that the decision for application of standard or non-standard contracts is a significant one.

The second decision in this stage concerns the degree of contract completeness. Formal contracts represent promises or obligations to perform particular actions in the future (Macneil, 1980). The act of contracting has two dimensions: codification and enforcement (e.g. see Hage and Aiken, 1966). The process of codification creates perceptual and conceptual categories that facilitate the classification of phenomena (Boisot, 1998). Enforcement refers to a situation in which things that are laid down are "in force". Contract completeness has frequently served as a proxy for the extent to which participants in interorganizational relationships attempt to coordinate and control interorganizational activities and outcomes (e.g. Anand and Khanna, 2000b; Masten and Saussier, 2002). Although higher levels of contract completeness facilitate coordination and control, they also entail higher transaction costs (Williamson, 1985), and reduced flexibility (Luo, 2002; Mintzberg, 1994). This dilemma heightens the salience of contract completeness decisions.

Interrelationships between governance decisions

Relatively little is known about why and in what way governance mechanisms are combined (Kirsch, 1997). Argyres and Liebeskind (1999) introduced the notion of governance inseparability to describe situations where there are interdependencies between governance decisions. Leiblein adds that 'a firm's past and current governance decisions constrain [and enable] the range and types of governance mechanisms that it can adopt in subsequent exchanges.' Although these and other researchers have presumed that there are potential interdependencies across individual governance decisions (Heide, 2003), it is unclear as to what the nature of these interdependencies is. As we wish to support our conceptualization of governance trajectories, we are interested in whether, and to what extent decisions on interorganizational governance are related *within a single relationship*. In this respect, Avadikyan et al. (2001: 1448) suggests that the life of an interorganizational relationship should be considered as 'a succession of [value] allocation and creation problems and the events taking place within a given phase have strong impacts on the following periods.' Authors have suggested that some governance decisions might serve as constraints on subsequent attempts to develop particular types of governance (Heide, 1994). Others have demonstrated that governance decisions made at the beginning of relationships influence governance decisions made later on. The selection of a

familiar partner, for example, has been found to influence contract completeness, as the need to reduce opportunistic behavior is probably lower (Gulati, 1995), whereas the ability to contract is probably higher (Poppo and Zenger, 2002). Similarly, higher selection efforts might enhance partners' abilities to record certain issues, heightening levels of contract completeness. It appears that combinations of governance mechanisms generate positive synergy or negative tensions (Cardinal, 2001), making examinations of how governance decisions relate to each other highly pertinent (Heide, 1994; Reuer, 2000). The six governance decisions that have been identified here should each at least possess one direct link with another governance decision, for the concept of governance trajectories to be of any value. In fact, if governance decisions are independent from each other, investigations of singular decisions remain appropriate. We formally state this in our first hypothesis.

Hypothesis 9.1: *each of the six governance decisions in the selection, negotiation, and contracting stages at least influences, or is influenced by one other governance decision in the same governance trajectory.*

Antecedent sets of governance decisions

We are interested in whether the antecedents of the six governance choices differ³⁴. If this appears to be the case, the value of studying entire governance trajectories would increase as opposed to investigating singular governance decisions. After all, in their efforts to coordinate and control, organizations are likely to deploy those governance mechanisms that fit most with the characteristics of the organization and the specific relationship (Colombo, 2003; Madhok, 2002). Coordination and control requirements that cannot be fulfilled by a particular governance mechanism might be accomplished through other governance mechanisms, dependent on the organizations involved in the relationship and the cooperation's characteristics. Examining the relationship between antecedents and a range of governance decisions appears to offer a more comprehensive picture of partners' governance efforts in this case. Conversely, when each of the governance mechanisms discerned has the same set of antecedents, investigating singular governance decisions suffices. In this case, results from analyses of one governance decision can serve as a basis for inferences about relationships between the same set of antecedents and other governance decisions.

Consistent with prior work (e.g. Chen, 2003; Reuer and Zollo, 2005; Saxton, 1997), and in line with recommendations by Colombo (2003), Heiman and Nickerson (2004), Madhok (2002), Reuer and Zollo (2005) and Takeishi (2001), we include both firm-level and transaction- or relational level factors as explanatory variables of governance choices. This conforms with Williamson's (1999: 1103) argument that rather than ask the question what is the best to organize X, which is the traditional transaction cost query, the question to be put

³⁴ Explanations underlying the use of different governance mechanisms have rarely been empirically investigated (for an exception, see Kumar and Seth, 1998).

instead is 'How should firm A [...] organize X?' It also aligns with findings from McGahan and Villalonga (2003) that governance forms depend on enduring firm characteristics. This distinction indicates that not only do transaction particulars matter, but also firm characteristics, like resources, governance skills, and experience (Madhok, 2002). However, 'little has been done specifically in examining the effect of partner characteristics on the choice of alliance forms' (Chen, 2003: 115). Colombo's (2003: 1224) therefore remarks that 'bringing the consideration of firms' idiosyncratic capabilities into the governance question [...] is a valuable complementary addition to more traditional arguments based on TCE and other contractual theories.' The effects of most of these antecedents on each of the governance decisions are intuitively straightforward; antecedents influence the need for coordination and control, or the ability to do so by means of the governance mechanism in question (Gerwin, 2004; Helm and Kloyer, 2004), or both. Based on existing literature, we distinguish several relational-level and organization-level antecedents that have been found to relate to one or more of the six governance decisions. Relational-level antecedents include the financial volume, complexity, and asset-specificity involved in a relationship, and the measurability of inputs, outputs and behavior. Organization-level variables predicting governance decisions include the sizes of the organizations involved, their expertise with respect to legal issues and the goods or services exchanged, and their experience with other interorganizational relationships. As some context-structure boundaries might be more salient predictors of structure and performance than others (Khandwalla, 1974) and because multiple contextual factors might have conflicting implications for the appropriate structure of an organization (Child, 1997), we take into account several antecedent variables of formalization here. When different governance strategies are found to be appropriate under different conditions, this would provide support for the fact that interorganizational governance is a heterogeneous phenomenon, subject to systematic variation (Heide, 1994; Macneil, 1980). It would not imply that 'conditions' for applying different governance mechanisms are mutually exclusive (Grandori, 2000), since antecedent sets of various governance decisions may partly overlap. However, as long as entire sets of antecedents of different governance decisions do not coincide, this would demonstrate the efficacy of the concept of governance trajectories. We therefore propose that the six governance decisions have disparate sets of antecedents.

Hypothesis 9.2: *each of the six governance decisions in the selection, negotiation, and contracting stages is associated with different sets of organization-level and relational-level antecedents.*

9.4 Method

We notice that gathering longitudinal data to examine process dynamics across stages is extremely hard. Analogue to Jap and Ganesan (2000), we therefore examine data that have been collected at one point in time, and we classify variables along different stages of a relationship. Subsequently, we perform ordinary logistic regression to explain the variation in governance mechanisms

that are measured on continuous scales, and we apply logistic regression analyses to predict the application of governance mechanisms that are measured on dichotomous scales. Although our results are generally consistent with other research based on the same data (see Batenburg et al., 2003; Buskens, 2002), we shift the analytic focus from the application of singular governance mechanisms towards series of governance decisions. Our analysis differs from these studies, because they either involve a smaller number of governance mechanisms (Buskens, 2002), or because they reduce the governance mechanisms that we distinguish to one additive measure (Batenburg et al., 2003).

Measurement

Consistent with previous research (e.g. Kale et al., 2000; Oxley and Sampson, 2004), *prior cooperation* is measured by a dummy variable, indicating whether the buyer and the supplier have undertaken business with each other before or not (0= no previous relationship, 1= previous relationship). With respect to *partner selection efforts*, most inquiries have focused on the type of selection criteria organizations apply in different contexts (e.g. Hitt et al., 2000; Nielsen, 2003). However, since interorganizational relationships vary as to the contexts and settings in which they take place, the tasks concerned, and the organizations involved, attempting to identify a universal list of criteria that organizations should employ when seeking an appropriate partner seems futile (Hitt et al., 2000). To secure a higher external validity of our findings, we use the number of men-days spent by a buyer on the selection and comparison of suppliers and their products as a proxy for selection efforts. The distribution of responses in terms of this indicator ranges from zero to three hundred days and is highly peaked and skewed. Most buyers had only spent a day or two on supplier and product selection, while a few invested a substantial amount of time. The variable is therefore subjected to a double square root transformation, rendering a normal distribution (see also Dekker, 2003). *The decision as to whether or not to pay a supplier in advance* is measured by a dummy variable (0= no advance payment, 1= advance payment). The *exhaustiveness of negotiations* between buyers and suppliers was measured by the extent to which 24 financial, legal, and operational issues were discussed by the buyer and supplier during negotiations on the transaction on a three-point scale (1=little, 2=normal, 3= a lot). Issues included were: price determination; liability of the supplier; restrictions on product use; price-levels; force majeure; nondisclosure by the buyer; up-dating; arbitration arrangements; settlement of R&D costs; joint management; technical specifications; termination period; price changes; warranties; insurance by the supplier; payment terms; quality (norms); service periods; sanctions for late payment; intellectual property rights; the reservation of spare parts; delivery times; protection of the product; and, maintenance periods. The variable consists of a count measure of the values for all terms, implying that a minimum value of 24 and a maximum value of 72 could be obtained. The *decision to apply a standard form contract or a tailor-made contract* is measured by a dummy variable (0=tailor-made contract, 1= standard form contract). The final governance decision, *contract completeness*, is constructed from the respondent's answers regarding the presence or absence of 24 contract clauses. Individual contract terms receive

a value of one when the respondents indicated that they were included as a clause in the contract, whereas they are coded zero when the subject was only arranged verbally, or when it was not arranged at all. Subsequently, contract completeness is calculated as a count measure of the contractual agreements on the 24 financial, legal, and operational issues that were actually included in the contract. All of the scales have satisfactory reliability and have undergone multiple validity tests. To circumvent duplication we refer to the method sections of themes one and four for the measurement of the following variables: financial volume, interorganizational complexity, asset-specificity, firm size, importance of reputation, and alternative options. We elaborate on the measurement of the other antecedents and control variables in Textbox 9.1.

TEXTBOX 9.1

Overview and measurement of antecedents and control variables

Transaction-level variables

Measurability of inputs, outputs, or behavior in a relationship often connects to high uncertainty (Poppo & Zenger, 2002). It has been suggested to complicate the design of appropriate contracts (Blumberg, 2001; Ouchi, 1979; Ouchi & Maguire, 1975; Eisenhardt, 1989b). It refers to the fact that 'even though management defines bureaucratic measures as both legitimate and effective, it may, nevertheless, be unable to implement these patterns' (Gouldner, 1954: 146). In contrast, others put forward that, if necessary, managers 'try to find decision rules, information sources, and structural designs that provide adequate understanding' to cope with low measurability and uncertainty (Daft & Lengel, 1986: 555). The influence of measurability on governance decisions has therefore remained ambiguous. The degree of measurability is captured by three items. At the first item, the respondent had to indicate 'how difficult it was for his or her organization to compare this product with similar products.' The second item asked 'how difficult it was for his or her organization to compare the price-quality ratio of potential suppliers' The third item asked whether 'it was difficult or hard for your employees to evaluate the quality of this product at the time of delivery' Responses follow a 5-point Likert-scale (1= 'very easy,' 5= 'very difficult'). As the ability to formalize is a construct with a positive orientation, the scales were reverse-coded. Cronbach's α for this scale was equal to 0.79. The construct validity of this measure is assessed by analyzing its correlation with the focal organization's relative experience with automation compared to other organizations in the same industry. Pearson's correlation statistic for both variables is equal to .30 ($p < .00$), indicating that organizations that are relatively more experienced with automation possess a higher ability to formalize, something which strongly reinforces our belief that our measure is appropriate.

Organization-level variables

Organization-level variables influencing governance decisions consists of the *buyer's legal expertise*, its *expertise concerning the transacted goods or services*, and *expertise derived from other relationships*. For example, as buyers with legal expertise are likely to be better able to negotiate and contract, their possession of legal expertise is proposed to increase the extensiveness of negotiations and the completeness of contracts. Buyers with legal experts are further assumed to be aware of the downsides of standard contract usage, which reduces the likelihood that those are used. This resonates with findings from Leiblein and Miller (2003), from their study on 469 make-or-buy decisions of 117 semi-conductor firms, which show that organization-level characteristics, like experience with a certain domain, influence governance decisions.

TEXTBOX 9.1 (continued)

Overview and measurement of antecedents and control variables

Organization-level variables

Buyers may differ in their ability to select attractive sourcing partners, negotiate, and enforce supplier contracts, design systems to manage relationships outside of the hierarchy, or to monitor and enforce contractual compliance (e.g. Anand & Khanna, 2000a; Ring, 2002), and they might be more or less capable of interacting with other companies or in creating value in interorganizational relationships (Dyer et al., 2001; Lorenzoni & Lipparini, 1999). The buyer's legal expertise is measured as a dummy variable indicating whether the buyer has employees or departments with legal expertise or not (0= no, 1= yes). The buyer's expertise concerning the transacted goods or services is measured by a dummy variable indicating whether the buyer has employees or departments with IT expertise or not (0= no, 1= yes). Finally, the extent to which the buyer has experience with how to manage interorganizational relationships is proxied by the extent to which it has few or many connections with other organizations (Hoang and Rothaermel, 2005). It is measured by a question indicating whether the buyer has any relationships or cooperative agreements with other organizations with respect to R&D, purchasing & sales, or transport (0= no, 1= yes).

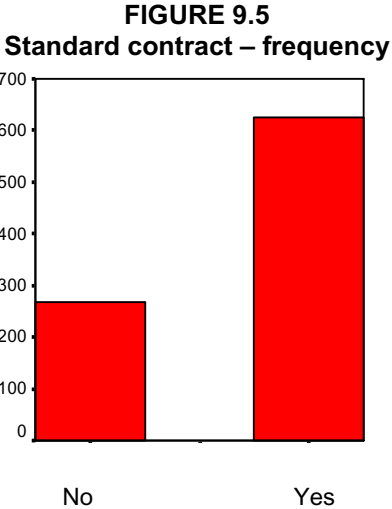
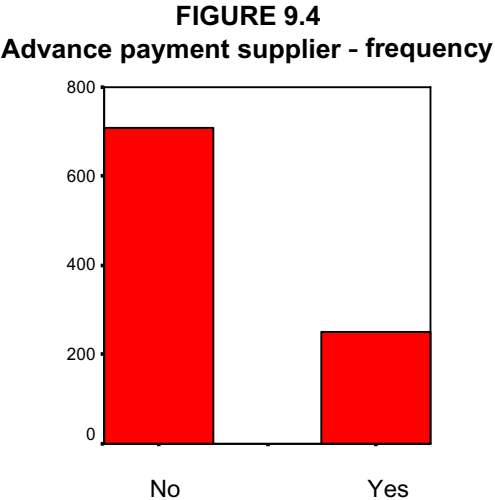
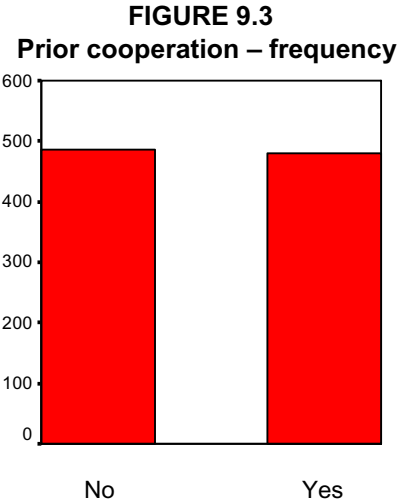
Control variables

Perceived dependence was measured by one indicator, described as 'the respondent's estimation, before the transaction, of the buyer's dependence on the supplier.' The response categories ranged from 1='very small' to 5='very large'. First user group describes whether the buyer belonged to the first group of users of the product in its industry (1= belonged to the first user group, and 0= did not belong to the first user group). Age of the supplier and the respondent measures the number of years the supplier is active in the IT-branch, and the age of the person answering the questionnaire respectively.

9.5 Results

We argued that if governance decisions at various stages of cooperation are influenced by different antecedents, and if they show an association with at least one other governance decision in the same relationship, this would support our conceptualization of sequences of governance decisions as governance trajectories. Before we can draw any conclusions, we have to proceed through several steps. First, we offer several descriptive statistics of the data used in our analyses. The three dichotomous governance decisions show significant variance, witnessing the distribution of values displayed in Figures 9.3 to 9.5. It appears that, in about half of the cases in our sample a familiar partner is selected. Advance payment of a supplier occurs in around 25 percent of the cases, whereas standard contracts are used in the majority of the relationships studied. The extent of selection efforts, negotiations, and contract completeness are not visualized, as they exhibit normal distributions. Table 9.1 depicts correlations between the six governance decisions (Appendix D presents the remainder of the correlations).

Familiarity is associated with lower selection efforts, fewer instances of advance payment, less exhaustive negotiations, and less complete contracts. The correlations between the other governance mechanisms all favor a complementarity view on governance mechanisms. Selection efforts, advance payment, exhaustiveness of negotiations, and contract completeness exhibit positive relations with each other, while they correlate negatively with the application of standard contracts.



In order to answer our research question, we now perform binary logistic regression analyses (for dichotomous governance decisions) and multiple regression analyses (for governance decisions with a continuous character). We first perform binary logistic analyses on the three dichotomous governance decisions, after which we undertake multiple regression analyses on the remaining governance variables, which are measured on continuous scales. As we require the combined results from these analyses for rejecting or accepting our hypothesis, conclusions can only be drawn after both analyses are performed.

TABLE 9.1
Bivariate correlations

	Mean	SD	1 ¹	2	3 ¹	4	5 ¹	6
Prior cooperation ¹	.50	.50	1.00					
Selection efforts	1.58	.710	-.18	1.00				
Advance payment ¹	.26	.441	-.10	.15	1.00			
Exhaustiveness negotiations	40.2	7.86	-.13	.38	.14	1.00		
Standard contract ¹	.70	.46	.02	-.16	-.16	-.16	1.00	
Contract completeness	10.7	5.84	-.13	.41	.21	.58	-.10	1.00

¹ Correlations with binary variables consist of Kendall’s tau-b. Correlations higher than .072 are significant at the 0.05-level. Correlations higher than .085 are significant at 0.01-level.

Binary logistic regression analyses

The objective of the binary logistic regression analyses is to correctly predict decisions concerning collaboration with a familiar or an unfamiliar partner, advance payment of a supplier, and the application of standard contracts. Predictions of these decisions for particular interorganizational relationships are based on the values of organization- and relation-level antecedents, which were distinguished earlier. The prediction equations equal:

$$\text{Prob (Y)} = \frac{e^{B_0 + B_1 \cdot \text{FINANCIAL VOLUME} + B_2 \cdot \text{COMPLEXITY} + \dots + B_{15} \cdot \text{AGE RESPONDENT}}}{1 + e^{B_0 + B_1 \cdot \text{FINANCIAL VOLUME} + B_2 \cdot \text{COMPLEXITY} + \dots + B_{15} \cdot \text{AGE RESPONDENT}}}$$

Table 9.2 exhibits a compilation of classification and fit statistics for the analyses of each of the three dichotomous governance decisions. The analysis of the decision to select a familiar or an unfamiliar partner, for example, encompasses 420 observations. In 215 instances, previous cooperation had taken place, rendering 51.2 percent of predictions as being correct if no explanatory variables were included in the analysis. Instead, the model predicts 65 percent of the cases correctly. Nagelkerke R², an alternative measure of the amount of explained

variance for binary logistic regression analyses equals .174. The p-value of the Hosmer-Lemehow test indicates that all models adequately fit the data (see Tabachnick and Fidell, 1996).

TABLE 9.2
Compilation of classification and fit statistics

		Prior cooperation: predicted		
		No	Yes	% Correct
Prior cooperation: observed	No	132	73	64.4
	Yes	74	141	65.6
Overall Percentage				65.0
Hosmer-Lemehow test				.773
Nagelkerke R ²				.174
		Paid in advance: predicted		
		No	Yes	% Correct
Paid in advance: observed	No	285	13	95.6
	Yes	92	27	22.7
Overall Percentage				74.8
Hosmer-Lemehow test				.285
Nagelkerke R ²				.148
		Standard contract: predicted		
		No	Yes	% Correct
Standard contract: observed	No	50	82	37.9
	Yes	25	239	90.5
Overall Percentage				73.0
Hosmer-Lemehow test				.269
Nagelkerke R ²				.193

Table 9.3 displays the results from the binary logistic regression analyses. Higher degrees of asset-specificity ex post are associated with a lower likelihood that a familiar partner is selected. This finding suggests that buyers in interorganizational relationships might benefit from relation-specific investments, which they have made in earlier transactions with the same supplier. Congruent with arguments from Lane and Lubatkin (1998), Dyer and Singh (1998) and Zollo et al. (2002), we thus suggest that organizations tend to select familiar partners for their collaborative ventures because this reduces investments required for developing knowledge-sharing routines and partner-specific knowledge, which are likely to have already taken place in prior exchanges between these organizations. Or in Williamson's (1999: 1103) words, in such cases 'the alignment calculus will be tilted in favor of the form that possesses such specialized' capacity.

TABLE 9.3
Results binary logistic regression analyses

	Prior cooperation			Advance payment			Standard contract		
	B	Sig.	Exp(B)	B	Sig.	Exp(B)	B	Sig.	Exp(B)
Financial volume	-.147		.864	.392	***	1.480	-.291	***	.747
Complexity	-.085		.918	.102		1.107	-.146	**	.864
Asset-specificity	-.120	***	.887	-.005		.995	.020		1.020
Measurability	.091	**	1.096	.014		1.014	.013		1.013
Size buyer	.006		1.006	-.037		.964	-.467	***	.627
Size supplier	.002		1.002	.014		1.014	.386	***	1.471
Legal expertise	.013		1.013	.196		1.216	.103		1.108
Other relationships	.014		1.014	.385		1.470	-.022		.978
IT-expertise	-.392		.675	-.195		.823	.187		1.205
Importance reputation	.107	*	1.113	.010		1.010	.027		1.028
Alternative options	.106	*	1.112	-.072		.930	-.078		.925
Perceived dependence	.249	**	1.283	.186	*	1.204	-.216	**	.805
First user group	-.497	**	.609	.338		1.402	.280		1.324
Age supplier	.339	***	1.404	-.339	***	.712	-.039		.962
Age of respondent	-.010		.990	.014		1.014	-.023		.978
Constant	1.058		.057	-2.593	***	.075	5.165	***	175.0
Nr. of observations †			420			417			396
Hosmer-Lemehow test			.773			.285			.269
Nagelkerke R ²			.174			.148			.193

† Due to the fact that the number of observations per variable was large, cases with missing values were excluded listwise. Correlations significant at the 0.10-level (*). Correlations significant at the 0.05-level (**). Correlations significant at the 0.01-level (***).

This finding thus lends support for Williamson's (1985) description of the "fundamental transformation" phenomenon. Williamson argues that in the presence of relation-specific investments – in this case, investments that have been conducted in previous exchanges – partners can create higher gains from trade if they stay together than if they separate. If partners have already committed to each other through previous investments in coordination mechanisms, which aid in the governance of subsequent interactions, for example, they have to invest less during new transactions with the same partner (Sobrero and Roberts, 2002). Relation-specific assets thus foster long-term and repeat relationships (Brown et al., 2004).

In relationships marked by higher measurability, higher importance of reputation, and larger numbers of alternative options, cooperation with a familiar partner is more likely, suggesting that buyers revert to suppliers they know when assessments of product or service quality are more difficult, or when products are highly standardized. The positive relationship between measurability and the selection of a familiar partner corroborates with Hoetker's (2005) finding that notebook computer manufacturers tend to opt for more hierarchical governance choices when uncertainty increases. In this chapter, higher measurability appears to be associated with the selection for a familiar partner, suggesting that uncertainty reduction stemming from learning (see also Williamson, 1999) was one of the factors influencing partner selection. The positive association between the selection of a familiar partner and perceived dependence suggests that organizations are some occasionally forced to work with a familiar partner, possibly due to lock-in effects or relation-specific investments made earlier on. This could explain why organizations turn to familiar partners for new cooperative endeavors even though partner-specific experience has been found to adversely influence interorganizational performance (Hoang and Rothaermel, 2005). Klein Woolthuis et al. (2005) offer an example of this effect in their description of a cooperative relationship between FoodCom, a large producer and seller of specialty foods, and Processor, a firm specialized in developing a wide range of food ingredients. They remark that 'the reason that the partners did cooperate again was due to FoodCom's dependence on Processor's specialist knowledge, for which FoodCom had very few alternative partners to turn to' (Klein Woolthuis et al., 2005: 823).

When the buyer belongs to the first user group in its industry, cooperation with a familiar partner also becomes less likely, as previous cooperation has probably never taken place between any of the potential partners. Finally, the older the supplier, the more likely it is that the partners have cooperated before. The odds ratios indicate that the most influential antecedents consist of age of the supplier, first user group, and perceived dependence. The odds that a buyer selects a familiar partner, for example, decrease by a factor .609 when it belongs to the first user group of a product in its industry. These findings suggest that the selection of a familiar partner is not only determined by a focal organization's ability to discern capable and reliable partners, or the routinized and standardized selection of partners (Li and Rowley, 2002), but also by the availability of familiar partners (see also Singh and Mitchell, 2005), which is partly determined by the age of a familiar partner, and whether the focal organization belongs to the first user group. Moreover, it is influenced by the difficulty on the part of the focal organization to break away from a familiar partner, as indicated by investments in relation-specific assets performed during earlier interactions, and the perceived degree of dependence on a familiar partner. Our findings reveal that collaborations between familiar partners are probably reminiscent of lower degrees of asset-specificity, and higher degrees of measurability and perceived dependence. They are also more likely to involve older supplier organizations.

The decision to pay a supplier in advance or not was found to be predicted by the financial volume involved in a relationship and the perceived dependence of a buyer on a supplier. Both variables had a positive relationship with ex ante payment. In contrast, the supplier's age had a significant negative influence on the likelihood that the decision was taken to pay a supplier in advance. The odds ratios indicate that the most influential antecedent of advance payment consists of the financial volume involved in a relationship. When the financial volume increases one level, the odds that advance payments are made grows by a factor 1.480. This indicates that suppliers primarily demand advance payments from their buyers when the financial volume associated with an interorganizational relationship carries significant costs and/or risks if not passed on to the buyer. Antecedents of the use of standard contracts consist of financial volume, complexity, size of the buyer, and perceived dependence. These are all found to have a negative association with the use of standard contracts. Besides, the size of a supplier is found to have a positive influence on the use of standard contracts. Here, the odds ratios indicate that the most influential antecedents consist of size of the buyer and size of the supplier. This might be explained by the fact that larger suppliers possess more resources and experience to develop standard contracts, and that they have better opportunities for leveraging standard contracts over a larger number of transactions. Given that standard contracts are generally beneficial to suppliers (Korobkin, 2003), our finding that larger buyers show stronger resistance to the application of standard contracts, is not surprising.

Multiple regression analyses

The three other governance decisions pertain to the efforts put into partner selection processes, the exhaustiveness of negotiation processes, and the level of contract completeness. As these variables are measured on continuous scales, multiple regression analyses are performed. The models are specified accordingly:

$$Y = \beta_0 + \beta_1 \cdot \text{Financial volume} + \beta_2 \cdot \text{Complexity} + \dots + \beta_{15} \cdot \text{Age} + \varepsilon$$

Table 9.4 displays the results of the regression analyses. Approximately thirty percent of the variance in selection efforts is explained by the specified antecedents (R^2 adjusted = 0.297). Consistent with previous work on partner selection (Buskens, 2002; Buskens et al., 2003), selection efforts are influenced by financial volume, importance of reputation, and the prevalence of other relationships between a buyer and external organizations, which have a significant positive association with selection efforts. Investments in relation-specific assets tend to increase the exhaustiveness of firms' selection efforts, something consistent with previous findings (e.g. Heide and John, 1990). Measurability appears to have a negative effect on search and selection efforts, which is congruent with descriptions of partner selection efforts as being driven by uncertainty (Beckman et al., 2004). Finally, a supplier's age also negatively influences search and selection efforts, which can be explained by the fact that older suppliers have better-known accomplishment records, while they might also be perceived as being less risky business partners.

TABLE 9.4
Results multiple regression analyses

	Selection efforts		Negotiation efforts		Completeness contract	
	B	Sig.	B	Sig.	B	Sig.
Financial volume	.323	***	.136	**	.231	***
Complexity	.032		.122	**	.080	*
Asset-specificity	.140	***	.117	**	.068	
Measurability	-.184	**	-.037		.095	**
Size buyer	.054		-.011		-.044	
Size supplier	.056		.114	**	.304	***
Legal expertise	.068		.062		.094	**
Other relationships	.089	**	.019		-.002	
IT-expertise	.034		.025		-.039	
Importance reputation	.113	**	.243	***	.160	***
Alternative options	.011		-.065		-.082	*
Perceived dependence	-.053		.145	***	.067	
First user group	-.016		-.040		-.080	*
Age supplier	-.089	*	-.122	**	-.068	
Age of respondent	.024		-.080	*	.043	
Constant	-.421		22.6	***	-2.87	
Number of observations †	406		419		419	
R ² adjusted	.297		.246		.309	

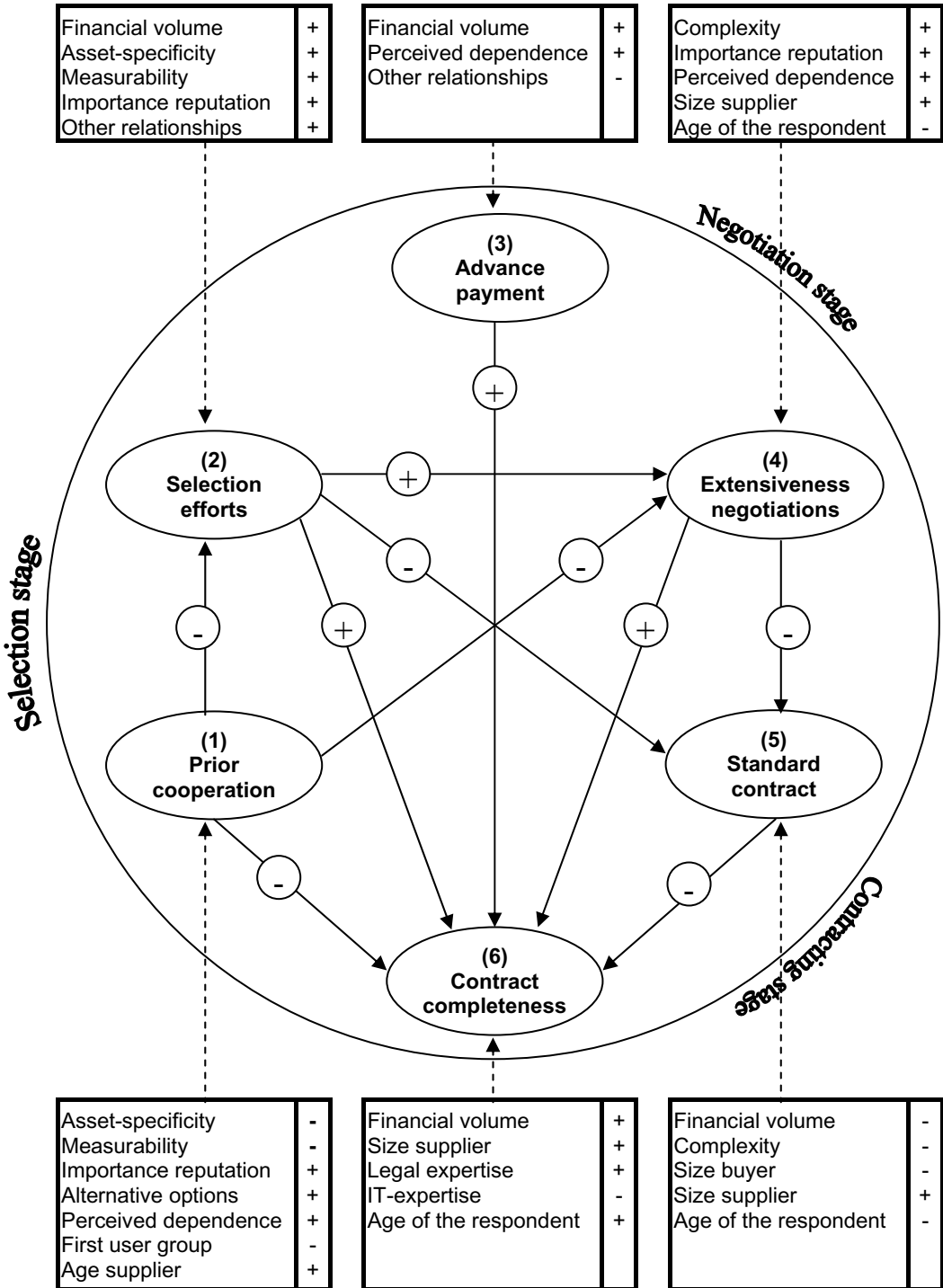
† Due to the fact that the number of observations per variable was large, cases with missing values were excluded list-wise. Correlations significant at the 0.10-level (*). Correlations significant at the 0.05-level (**). Correlations significant at the 0.01-level (***).

Considering negotiation exhaustiveness, almost 25 percent of the variance is explained by the specified antecedents. Financial volume, complexity, asset-specificity, size of the supplier, importance of reputation, and perceived dependence are found to have a significant positive association with the extent of negotiations. Age of the supplier and age of the respondent exhibit a significant negative relationship to negotiation exhaustiveness. Finally, more than thirty percent of the variance in contract completeness can be explained by the specified antecedents. Financial volume, complexity, measurability, the importance of reputation, legal expertise, and the size of the supplier have a significant positive relationship to contract completeness. The existence of alternative options and membership of a first user group have a negative

relationship to contract completeness. The latter conforms with findings of Gainey and Klaas (2003) indicating that partners that are less experienced and knowledgeable about a certain type of relationship find it more difficult to avoid incomplete contracting.

We now extend previous work by researchers using the same database (Batenburg et al., 2003; Buskens, 2002), by assessing whether previous governance decisions influence subsequent governance decisions. We perform hierarchical analyses in which we add preceding governance decisions in the analyses one at a time. In appendix E, we furnish an overview of the relationships between the antecedents and the six governance decisions. In the models with extensions b, c, d, e and f, we added the governance variables familiarity with a partner, selection efforts, advance payments, negotiation efforts, and standard contract as explanatory variables for subsequent governance decisions. It appears that the decision to cooperate with a familiar partner has a negative effect on selection efforts, negotiation exhaustiveness and contract completeness. The latter corroborates findings from Anand and Khanna (2000b) who suggested that contracts between familiar organizations are systematically different from the ones in de novo pairings. It conforms with an observation from Klein Woolthuis et al. (2005: 828) that some firms do not fear opportunism when negotiating and contracting, because of their earlier experience with the other party. Our finding might also be an indication of the fact that a higher familiarity between partners shifts their focus from value appropriation concerns to value creation issues (Koka and Prescott, 2002). Selection efforts, in turn, positively influence the extent of negotiations and contract completeness, while they exhibit a negative relationship to the use of standard contracts. This confirms Rooks' (2002) assertion that search and selection is a potential mediator of the relationship between antecedents and formalization. Searching, screening, and selecting suppliers and products helps to assess the reliability and level of competence of a potential supplier, thereby reducing the risk of a transaction, and possibly reducing the need for formalization. Our findings imply, however, that the ability to formalize has a more significant influence. Advance payment does not appear to be influenced by other governance decisions, but it does itself influence the degree of contract completeness. Finally, the exhaustiveness of negotiations reduces the use of standard contracts and propagates contract completeness. In Figure 9.6, we have depicted the interrelationships found between the governance decisions and the relationships between sets of significant antecedents and each of the governance decisions. It appears that each of the governance decisions discerned in the chapter at least influences one other governance decision in the same governance trajectory, which leads us to accept hypothesis 9.1. Moreover, the six governance decisions discerned are all associated with different sets of organization-level and relational-level antecedents, supporting hypothesis 9.2.

FIGURE 9.6
Relationships between governance decisions and sets of antecedents



9.6 Discussion

In theme six, we noticed that although findings from empirical investigations of interorganizational governance frequently concentrate on single governance modes in isolation (Kirsch, 1997), and that most studies on interorganizational governance are not integrative across mechanisms, with each study considering one or two rather than a range of mechanisms (Geringer and Hébert, 1991a). However, examining only one or two governance mechanisms at a time is at odds with the observations that multiple mechanisms are strongly interrelated and that they all have their bearing on interorganizational performance. Reuer (1999), for instance, contends that potential value creation in interorganizational relationships warrants appropriate selection of partners, alliance designs, and adaptations by the partners. The disparity between managers facing a plethora of presumably connected governance choices and the attention that researchers have given to the connections between these choices leads us to our final research question.

RQ11: To what extent are decisions on formalization related to other governance decisions?

Key findings

We investigated this question by introducing the concept of governance trajectories. We proposed that these trajectories are composed of multiple interrelated governance decisions, which are each predicted by different sets of antecedent variables. Findings on a sample of 911 buyer-supplier relationships support our assertions, and they suggest that governance efforts can no longer be conceptualized as one-time events. It appears that managers govern their relationships during multiple stages of developments, and that the decisions they make early on in a relationship influence the decisions they make in later stages. Moreover, congruent with evidence from, among others, Chalos and O'Connor (2004), interorganizational governance decisions appear to be influenced by different sets of antecedents. This implies that although certain context- and task-characteristics might prohibit the application of particular governance mechanisms, they might not restrict the utilization of others. We therefore recommend managers to take multiple governance mechanisms, task-characteristics and contextual attributes into account when deciding on how they want to govern their relationships. Beyond supporting our conceptualization of governance trajectories, the results from our analyses encompass various findings related to each of the six governance mechanisms, on which we briefly elaborate here. The negative relationship between investments in relation-specific assets and the selection of a familiar partner confirms earlier findings and assertions on the significance of developing partner-specific skills and routines (Dyer and Singh, 1998; Gulati and Wang, 2003; Kale et al., 2002; Kotabe et al., 2003; Luo, 2002; Zollo et al., 2002). Besides, the positive relationship between measurability and the selection of a familiar partner coincides with arguments that familiar partners develop joint understandings that allow uniquely efficient communication, and which tend 'to help mitigate coordination, conflict resolution, or information-gathering problems' (Zollo et al., 2002: 703). Collectively, our findings suggest that

the selection of familiar partners is not only determined by a focal organization's ability to discern capable and reliable partners, or by the routinized and standardized selection of partners (Li and Rowley, 2002), but also by the availability of partners (see also Singh and Mitchell, 2005), and by the difficulty of the focal organization to break away from a familiar partner. Consistent with work from Ahuja (2000), this indicates that both inducements and opportunities – or needs and abilities – influence governance choices.

As far as we are aware, the decision to pay a supplier in advance and the decision to apply standard contracts have seldom been analyzed empirically. Advance payment of a supplier was found to hinge primarily on the financial volume of a transaction, while the selection of standard contracts appeared to be influenced mainly by firm sizes. In addition, we analyzed factors predicting the efforts put into the selection of partners for a transaction. Although more and more attention is paid to partner selection in the empirical literature, most attention has been paid to selection criteria, which differ per context and task characteristic (Geringer, 1991), and which complicate the generalization of findings from these studies. Our findings on the factors determining selection efforts can be more easily extrapolated to other interorganizational relationships, as they have a universal character. Particularly interesting was the observation that buyers that have more external relationships tend to exhibit more selection efforts, which suggests that these organizations are probably more aware of the significance of partner selection efforts compared to more inward looking companies. Regarding the exhaustiveness of negotiations and contract completeness, we observed that investments in relation-specific assets had a significant positive relationship with the exhaustiveness of negotiations, but no relationship with contract completeness. This contrasts with empirical studies from, among others, Shelanski and Klein (1995), Masten (1996), and Rindfleisch and Heide (1997). It could indicate that buyers realize that they have to make relation-specific investments, but that they find it difficult to protect themselves against these risks by writing complete contracts. Another explanation would be that relation-specific investments are relevant to broad level governance choices, but not to narrower choices such as the level of contract completeness (see also Carson et al., 2006). Moreover, measurability was found not to be associated with negotiation exhaustiveness, whereas it did exhibit a positive relationship with contract completeness. This indicates that higher degrees of measurability might not influence the need for coordination and control, but only the ability to do so. Furthermore, in line with arguments from Colombo (2003), Madhok (2002), and Reuer and Zollo (2005) organization-specific factors were found to influence governance decisions. Both negotiation efforts and contract completeness were positively influenced by supplier size, while the presence of legal expertise on the part of the buyer raised contract completeness. Finally, we elucidated how different governance decisions influence each other. It appeared that the decision to cooperate with a familiar partner has a negative effect on selection efforts, negotiation exhaustiveness and contract completeness. Selection efforts, in turn, positively influence negotiations and contract completeness, while they exhibit a negative relationship to the use of standard contracts. Advance payment is not

dependent on other governance decisions, but it does drive the degree of contract completeness. Finally, the exhaustiveness of negotiations reduces the use of standard contracts and propagates contract completeness.

Theoretical and practical implications

Our research departed from prior studies by simultaneously considering the application of multiple governance mechanisms along different stages in interorganizational relationships. Several theoretical and practical implications can be discerned. First, our findings imply that researchers might benefit from shifting their attention from studying singular governance decisions to investigating series of governance decisions. As we have shown, intricate relationships exist between governance decisions, while each of these decisions is influenced by different sets of antecedents. This suggests that more fine-grained analyses of managers' attempts to coordinate and control interorganizational behavior and outcomes are needed. Managerial implications predominantly concern managers' awareness of the effects of governance decisions made in earlier stages of cooperation on decisions and outcomes in later stages of cooperation. It appears that managers might use interdependencies between governance decisions deliberately (Heide, 2003). They may invest more in partner selection, for instance, to increase their ability to negotiate with potential partners, to use better-tailored contracts, and to enhance contract completeness.

Limitations and opportunities for future research

Our research entails several limitations, which could be addressed in future research. First, we did not include interorganizational performance in our analyses. Performing path-time analyses, which was beyond the scope of this chapter, could well elucidate how sequences of governance decisions jointly influence interorganizational performance. Future studies might measure the performance effects related to the different governance mechanisms and governance decisions. These measures could refer to the interaction process between partners, and to the outcomes of interorganizational relationships (for a further elaboration on this distinction, see Ariño, 2003). Another possibility is to explicitly specify and measure the functions and dysfunctions mediating the relationship between each governance mechanism and interorganizational performance. Furthermore, Cardinal et al. (2004: 426) have advanced that effective controls be in a state of constant rebalancing, like the effective guided missile whose trajectory is rarely correct. Although we acknowledged the significance of time, dynamics related to the continuous balancing of controls were not included in this chapter. Inquiries into day-to-day adaptations in formalization might offer us the opportunity to ascertain how we can make sure that contracts, rules and procedures achieve their targets. Finally, our data did not permit us to investigate the influence of network characteristics on organizations' attempts to coordinate and control their interorganizational activities. Recent empirical studies (cf. Rowley et al., 2004) reveal that including network variables in interorganizational governance can offer valuable new insights.

10 REFLECTION AND DISCUSSION

10.1 Introduction

We started this thesis by indicating that interorganizational cooperation has become an important phenomenon in today’s business environment. However, we also advanced that collaboration is marked by many problems, which have to be addressed, and which may be circumvented or alleviated by adopting appropriate governance mechanisms. In particular, a need arose to increase our understanding of the forces shaping collaborative agreements (Olk and Elvira, 2001; Osborn and Hagedoorn, 1997) and of the processes that are used to design and manage interorganizational relationships. Such an understanding could contribute to improved managerial practices and a reduction in cooperative failures (Barringer and Harrison, 2000). In particular, we noticed that several authors have pointed at the significance of formalization for interorganizational relationships. These authors have called for a more integrative view on formalization in which its antecedents and performance effects are studied contemporaneously, and in which the effects of timing and context are incorporated (see Table 1.2). Their arguments indicated a need for broader and deeper knowledge of the role of formalization in interorganizational relationships, which was the focal point of this study, and which led to the following definition of the research problem: *What role does formalization play in interorganizational relationships?*

To investigate this research problem, we extended and refined the generic model on formalization that is prevalent in the literature (see Figure 10.1), and we undertook inquiries into six research themes that each focused on part of our research framework (see Figure 10.2). As the framework shows, the themes and the various perspectives underlying them are not incompatible, but they offer complementary explanations as to what the role of formalization is in interorganizational relationships. In this final chapter, we do not only present a synopsis of the key findings for each research theme, but we also discuss how these findings collectively contribute to an integrative picture of the role of formalization in interorganizational relationships. After summarizing the main arguments and findings, we elucidate the theoretical and practical implications of the study. Finally, we pay attention to limitations of the thesis, which eventuate in several opportunities for future research.

FIGURE 10.1
Generic framework derived from the literature

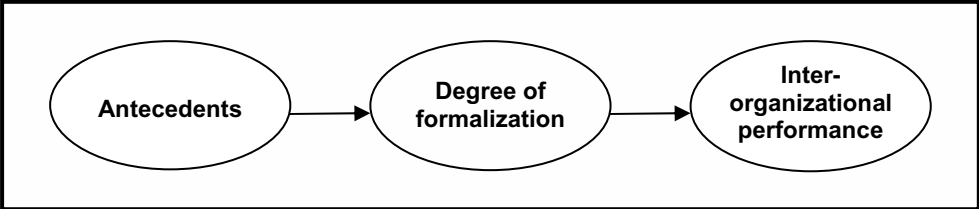
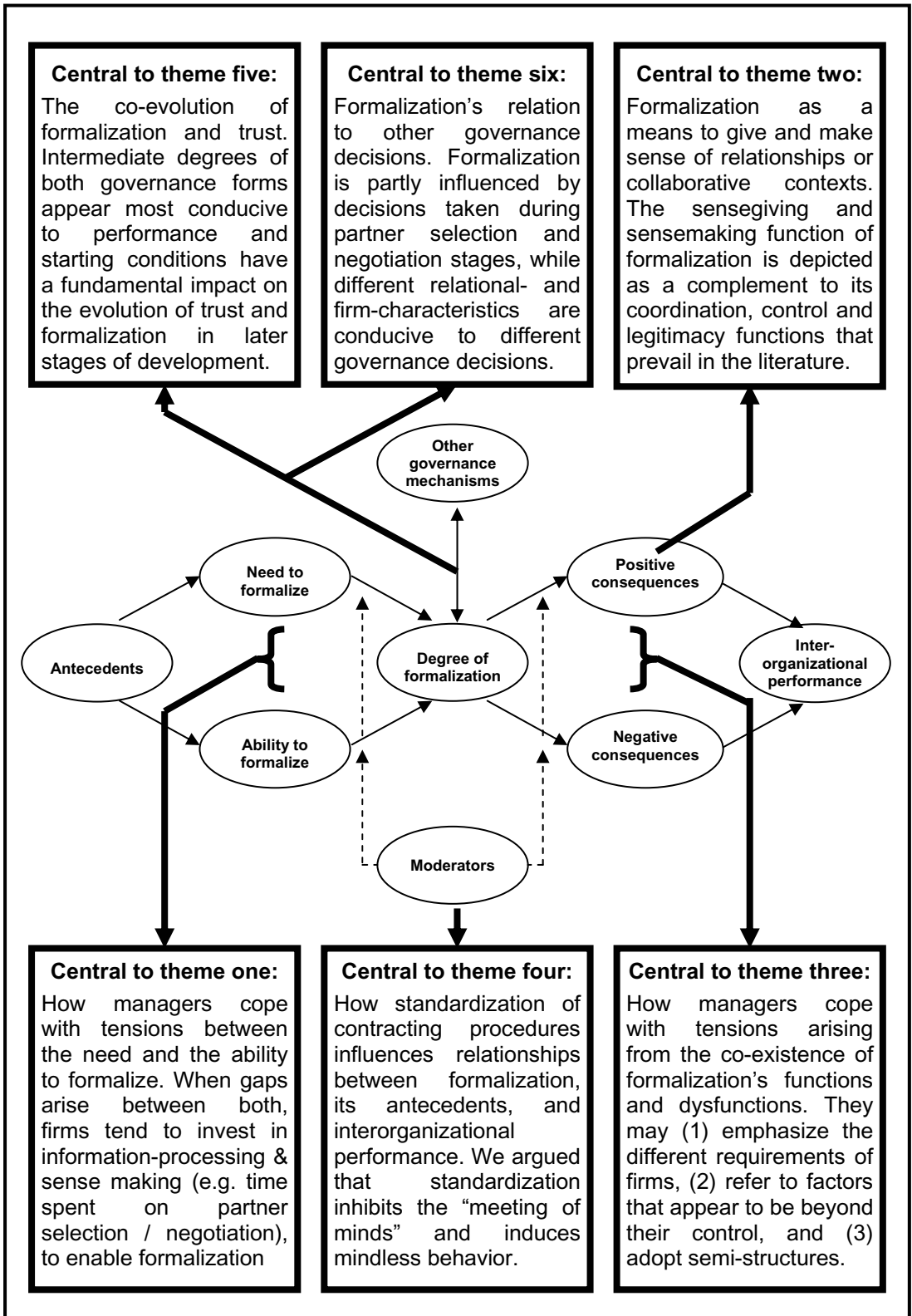


FIGURE 10.2
Research framework – contributions of the six themes



Theme one – need versus ability to formalize

In theme one, we investigated how the ability and the need to formalize eventually influence the degree of formalization in interorganizational relationships. We noticed that the literature reveals contradictory findings regarding the direction of several relationships between antecedents and formalization, which have to be reconciled. This led to the following research questions.

RQ1: To what extent do relationships between antecedents and the *ability* to formalize diverge from their relationships with the *need* to formalize?

RQ2: How do the ability and the need to formalize influence the degree of formalization in interorganizational relationships?

Our findings extend previous theoretical work on formalization by underscoring the idea that antecedents that are commonly associated with formalization (investments in relation-specific assets, interorganizational complexity, cooperation with an unfamiliar partner, and small focal organizations) give rise to multiple, contradictory forces. In particular, they may increase the need to formalize activities and outcomes, but they concurrently diminish the ability to do so. From our results, it accrues that tensions resulting from the co-existence of these forces induce participants in interorganizational relationships to invest in information processing and sensemaking activities, in order to make sure that formalization can be applied appropriately.

Main finding theme one

Antecedents that are commonly associated with formalization may increase the need to formalize activities and outcomes, while they concurrently diminish the ability to do so. Firms then tend to invest in information processing and sensemaking to facilitate formalization

Theme two – functions of formalization

The second theme was born out of the observation that understanding why economic agents use formalities, such as contracts, 'is crucial to understanding the organization and efficiency of economic exchange' (Masten and Saussier, 2002: 273). It was denominated "functions of formalization", because it concerned the underlying reasons or rationales for instituting formal interorganizational structures and practices. We observed that existing studies tend to focus either on formalization as a means to coordinate, or on formalization as a means to control (see for instance Gulati and Singh, 1998; Madhok, 2002), and into a lesser extent on formalization as a means to gain legitimacy (see Kale et al., 2002; Meyer and Rowan, 1977). These studies generally pass over the fact that formalization might have other functions (e.g. for notable exceptions see, for example, Ariño and Ring, 2004; Lindenberg, 2003; Zollo and Singh, 2004), and that there is a need for novel understandings of formal structures and practices (Hatch, 1999). We also expected that multiple functions of formalization co-exist, so that it became

requisite to examine how these functions are related to each other (see Foss and Foss, 2005; Madhok, 2002), how they influence interorganizational performance, and in which contexts or for which temporal stages each of the functions is most important. This led to the following research questions.

RQ3: What are the functions of formalization?

RQ4: How do these functions relate to each other?

RQ5: What is their relationship with interorganizational performance?

RQ6: What is the relative importance of each of these functions in different collaborative contexts and stages of interorganizational development?

By theorizing in broad conceptual categories, we were able to look beyond the narrow boundaries of single theoretical lenses supportive of the coordination, control and legitimacy functions of formalization. We believed that shifting attention to other functions of formalization could open up a new way of thinking about the meaning of formalization for the management of interorganizational relationships. Based on Weick (e.g. 1979, 1995, 2001) and Ring and Van de Ven (1989, 1994), we argued that formalization assists participants and stakeholders in interorganizational relationships in giving and making sense of the relationships that they are engaged in, and of the collaborative contexts in which those relationships are embedded. We explained that formalization's sensegiving and sensemaking function underlies its other functions, and that its relationship with interorganizational performance differs from that of other functions of formalization. We also advanced that formalization as a means to give and make sense is more pronounced in the beginning of interorganizational relationships, and in exploratory contexts.

Main finding theme two

Formalization does not only support coordination, control and legitimacy but it also assists participants and stakeholders in interorganizational relationships in giving and making sense of the relationships they are engaged in, and of the collaborative contexts in which those relationships are embedded.

Theme three – duality & dialectic tensions

In theme three, we embraced the idea that dialectic tensions arising from the co-existence of positive and negative consequences – or functions and dysfunctions – of formalization are hard to solve (Ring and Van de Ven, 1989), and may have to be managed instead (Huxham and Beech, 2003). By emphasizing managerial choice (Child, 1997), we aimed to elucidate how managers cope with the tensions arising from the co-existence of formalization's functions and dysfunctions (see Das and Teng, 2000; De Rond, 2003; De Rond and Bouchiki, 2004). In line with this, we formulated the following research question:

RQ7: How do managers of interorganizational relationships cope with tensions arising from the co-existence of formalization's functions and dysfunctions?

A review of the literature revealed how formalization functions as a means to coordinate, as a means to control, as a means to persuade and convince stakeholders, and as a means to make sense. It also highlighted a number of dysfunctions associated with formalization, including, for example, its retarding effect on creativity and innovation, and its role in inhibiting flexibility needed for coping with complex, ambiguous and unstable task environments (Camillus, 1975; Mintzberg, 1994; Nootboom, 1999). By means of a case study of a cross-industrial strategic alliance, we illustrated that managers attempt to cope with the resulting tensions between functions and dysfunctions of formalization in at least three ways. First, they alternate their emphasis on disparate levels of formalization required by each of the partner. Second, they justify formalization by referring to factors that appear to be beyond their control. Third, they use a kind of semi-structure, emphasizing either formalization of outcomes or formalization of processes.

Main finding theme three

Although managers may make the "right" decisions, in that they select an appropriate degree of formalization for the prevailing firm, task and contextual characteristics, they are inevitably confronted with tensions between the functions and dysfunctions of formalization, with which they have to cope.

Theme four – contract standardization

In theme four, we observed that the use of standard form contracts and standard procedures for negotiation and contracting is widespread (Korobkin, 2003). Nonetheless, hardly any inquiries have been made into the influence of contract standardization on interorganizational cooperation, apart from some incidental research in law schools (e.g. Epstein, 1999; Kahan and Klausner, 1996, 1997; Korobkin, 2003). In theme four, we redressed this imbalance between research and practice by examining how a discussion of standardization could shed new light on the role of formalization in interorganizational relationships. We addressed the following research questions:

RQ8: What are the advantages and disadvantages of using standard contracts in interorganizational relationships?

RQ9: What influence does the introduction of standard procedures for negotiating and contracting have on the generic research model for formalization?

To investigate these questions, we reviewed the literature and developed an overview of the factors that explain why managers deploy standard contracts and standard procedures for negotiation and contracting. Motives pertained to the efficiency of transactions; transaction speed and robustness; exploitation of

information asymmetry and prevention of unintended signaling; the legitimacy granted to standardized formalities; benefits of unequivocal interpretation; and, network-effects. Subsequently, we elaborated on the disadvantages of standardizing negotiation and contracting practices, such as low levels of contractual specificity, and a limited potential for developing mutual expectations and joint understandings. Following this, we exploited the assumption that standard procedures are accompanied by lower degrees of care and vigilance (Weick, 1979, 1995), proposing that the degree to which interorganizational negotiation and contracting processes are standardized moderates the relationships between formalization, its most common antecedents, and interorganizational performance. From our results, it accrues that standard procedures for negotiation and contracting might eventuate in a failure to communicate the content of a promise or to define the rights exchanged between partners (Goetz and Scott, 1985). Moreover, by de-contextualizing the contracting process, standard procedures reduce the degree to which parties can 'create a bigger transactional pie in a world where parties' incentives are misaligned and [where] they need to coordinate the production of information, specify future rights, duties, and procedures, and allocate risks' is the central aim of contracting (Hill and King, 2004: 890). In other words, we find that the use of standard procedures for negotiation and contracting potentially leads to reduced mindfulness by contracting parties, which may eventually diminish the usefulness of contracts.

Main finding theme four

Whereas standardization of negotiation and contracting procedures is known to have many advantages, it may also reduce mindfulness by contracting parties. Standardization may thereby diminish the usefulness of contracts.

Theme five – evolution of trust & formalization

In theme five, we noted that despite significant theoretical contributions on the significance of trust and formalization for interorganizational cooperation, the relationship between trust and control remains far from clear (Maguire et al., 2001; Sydow and Windeler, 2003), and that much theoretical input is still needed to understand how trust and formalization work as governance mechanisms (Bachmann, 2001). In particular, we observed that little attention has been paid to the evolution of formalization and trust during cooperative relationships (for notable exceptions, see Ferrin et al., 2005; Klein Woolthuis et al., 2005; Serva et al., 2005). Therefore, we investigated the following research question.

RQ10: How do formalization and trust evolve in interorganizational relationships?

Building on the work of other researchers (Ferrin et al., 2005; Klein Woolthuis et al., 2005), we indicated that intermediate levels of formalization and trust are probably most conducive to interorganizational performance. We also advanced that starting conditions – being the levels of trust and formalization in early stages of cooperation – are crucial to the development of both governance modes in later

stages of development. Our assertions were captured in an integrative conceptual framework (see Figure 8.4), which reconciles hitherto fragmented views on the evolution of formalization and trust in interorganizational relationships.

Main finding theme five

Intermediate levels of formalization and trust are probably most conducive to interorganizational performance and starting conditions – being the levels of trust and formalization in early stages of cooperation – are crucial to the development of both governance modes in later stages of development.

Theme six – governance trajectories

In theme six, we signalled that empirical investigations of governance problems in interorganizational relationships frequently concentrate on single governance modes in isolation (Kirsch, 1997); most studies on interorganizational governance are not integrative across mechanisms, with each study considering one or two rather than a range of mechanisms (Geringer and Hébert, 1991a). This appears to be at odds with the observation that several governance mechanisms are strongly interrelated and that multiple mechanisms have their bearing on interorganizational performance (Klein, 2002; Reuer, 1999). The disparity between managers facing a plethora of presumably connected governance choices and the attention that researchers have given to the connections between these choices led us to our final research question.

RQ11: To what extent are decisions on formalization related to other governance decisions?

We investigated this question by introducing the concept of governance trajectories. These trajectories consist of multiple interrelated governance decisions that are influenced by different sets of antecedent variables. Our findings suggest that governance efforts should no longer be conceptualized in the form of one-time events, as managers govern their relationships during multiple stages of development, and as decisions that they make early on in a relationship influence the decisions they make in later stages. Moreover, congruent with Chalos and O'Connor (2004), interorganizational governance decisions were influenced by different sets of antecedents, indicating that optimization occurs at the level of series of governance decisions and sets of context- and task-characteristics.

Main finding theme six

Governance efforts should no longer be conceptualized in the form of one-time events, as governance decisions are interdependent and as optimization of governance solutions occurs for series of governance decisions and sets of context and task characteristics.

10.3 Theoretical and practical implications

Our study has several theoretical and practical implications. First, our results indicate that “the manager” has to be brought back into research on interorganizational governance. This became apparent, among others, from theme one and theme three. In theme one, for example, we found that managers can influence the extent to which tensions between the need and the ability to formalize preclude formalization, by putting more or less efforts in information processing and sensemaking. In theme three, we elaborated on the tensions between the functions and dysfunctions of formalization, revealing how managers might cope with them. The findings from both themes indicate that shifting research attention from investigating the “right” degree of formalization – when taking into account the characteristics of relationships and organizations (Foss and Foss, 2005; Madhok, 2002; Williamson, 1985, 1991) – towards investigating *how managers make sure that the actual degree of formalization that is applied has a positive influence on interorganizational performance* could be valuable.

“The manager” has to be brought back into research on interorganizational governance. Research attention should shift from the “right” degree of formalization towards the managerial efforts that are required to make sure that formalization has a positive influence on interorganizational performance.

A second theoretical implication concerns formalization’s functioning in interorganizational relationships. Whereas researchers have called for ‘more systematic attention’ for the coordination function of formalization (e.g. Carson et al., 2006: 36; see also Mayer and Argyres, 2004), we provoke researchers to conduct inquiries into four major functions of formalization. In theme two, we clarified that formalization may not only function as a means to coordinate, as a means to control or as a means to legitimate, but also as a means to give and make sense of interorganizational relationships, and the collaborative contexts in which they are embedded. By facilitating sensegiving and sensemaking, formalization enables a “meeting of minds”, thereby contributing both to value creation (parties are able to envision a larger pie for the relationship) and value appropriation (it is more obvious to both parties which share of the pie they may eat). Explicitly distinguishing the sensegiving and sensemaking function of formalization from its coordination, control and legitimacy functions enables researchers and practitioners to state more explicitly why formalization takes place and through which of its functions formalization contributes to interorganizational performance. Nonetheless, as theme four on contract standardization indicates, the sensegiving and sensemaking function of formalization described in theme two may become endangered by standardization of negotiation and contracting procedures. The latter demands that researchers ask themselves whether it is formalization as an outcome, or formalization as a process that contributes most to interorganizational performance (see also chapter 3).

Researchers are advised to consider four major functions of formalization (coordination, control, legitimation and sensegiving and sensemaking), and to ask themselves whether it is formalization as an outcome, or formalization as a process that contributes most to interorganizational performance.

A third theoretical implication regards the interplay between formalization and other governance forms. In themes five and six, we have demonstrated that formalization is intricately related to other governance mechanisms, and therefore hard to isolate. Changes in trust, for example, may lead to changes in formalization (theme five), but decreases in selection efforts may do so as well (theme six). Moreover, theme five has shown that these changes can be positive as well as negative, dependent on the dominance of substitution or complementarity effects, and on the interpretation that managers give to the actions of a partner. Furthermore, changes in the degree of formalization may themselves trigger changes in other governance mechanisms, like trust. The intricate interrelationships between formalization and other governance mechanisms complicate assessments of formalization's relationship with interorganizational performance. In case governance mechanisms other than formalization are not explicitly included in the analysis of interorganizational performance, they may still influence the result. When researchers find a positive relationship between formalization and interorganizational performance, for example, this may be due to the higher selection and negotiation efforts that preceded it, or to particular levels of trust that enabled it. The inability to include entire governance trajectories in our analyses and the difficulties we face in mapping the evolution of formalization, trust and other governance forms may lead to spurious findings, erroneous interpretations, and faulty recommendations.

Intricate interrelationships between formalization and other governance mechanisms complicate assessments of formalization's relationship with interorganizational performance.

A fourth theoretical implication of our findings concerns the notion that prescription based on generic models of the research problem – e.g. antecedents influence formalization, which subsequently influences interorganizational performance – should be regarded with caution. The findings from all themes cast substantial doubt over the tenability of such conventional models, showing that these may have little normative value (see also Ghoshal and Moran, 1996). Managers may not match firm-level and transaction or relational level factors with formalization as predicted by theories such as transaction cost economics or agency theory, because these models do not account for: (1) variation in managerial responses to gaps between the need and the ability to formalize (theme one); (2) variation in the functions that managers seek to fulfill by deploying formalization (theme two); (3) variation in managers' capabilities to diminish the tensions between the functions and dysfunctions of formalization (theme three); (4) the use of standardized procedures for negotiation and contracting, which diminishes the strength of associations between antecedents and formalization (theme four); (5) the relationship between trust and formalization, and their co-evolution during collaborative relationship (theme five); and, (6) the availability of other governance mechanisms, which may show a better fit with firm-level and transaction or relational level factors than formalization (theme six).

Prescription based on generic models of the research problem – e.g. antecedents influence formalization, which subsequently influences interorganizational performance – should be regarded with caution.

A final theoretical implication concerns researchers' allegiance to single research paradigms. Our results show that research on formalization may strongly benefit from moving beyond the confines of theoretical streams, crossing the domains of theories, schools of thought and even scientific disciplines. Although the use of multiple theories across the research themes may seem to lead to theoretical incommensurability on first sight, it has also led to Figure 10.2 and to the insights associated with each of the research themes. This study thereby clearly shows that a pluralistic approach to interorganizational governance research promises to lead to richer and possibly more meaningful insights on the role of formalization in interorganizational relationships than has hitherto been attained.

Research on formalization may strongly benefit from moving beyond the confines of theoretical streams, crossing the domains of theories, schools of thought, and even scientific disciplines.

Our research also entails several practical implications. First, it shows managers that, to be effective, formalization generally has to be accompanied by information processing and sensemaking efforts. Such efforts reduce the tensions between a low *ability* to formalize and a high *need* to formalize, as they reduce uncertainty and ambiguity and because they assist in capturing aspects of the relationship more proficiently in formal documents than would otherwise be possible (see theme one). Second, the study elucidates that formalization can be utilized for other means than coordination and control. It also functions as a means to legitimate and as a means to give and make sense. Practitioners can use this knowledge to discuss more meaningfully about the rationales they have for formalization, or to justify attempts to formalize even in cases when coordination and control may in first instance be hard to attain by means of contracts, rules and procedures (see theme two). Third, our study indicates that managers should not only be working on getting the degree of formalization "right" (Foss and Foss, 2005; Madhok, 2002; Williamson, 1985, 1991), but also, and maybe even primarily, on managing the tensions that arise from the degree of formalization that eventually prevails. We recommend practitioners to develop strategies for circumventing, alleviating or mitigating the dysfunctions of formalization (see theme three). Fourth, managers may consider the use of standard contracts and standard procedures for negotiation and contracting in their relationships. Although we have illuminated multiple advantages of standardization, we have also explicated that standardization can prohibit a "meeting of minds" between partners, and we made clear that it could entail "mindlessness". These results imply that researchers have to consider attempts to standardize with caution (see theme four). Fifth, in our treatise on the relationships between formalization, trust and interorganizational performance, we elucidated that these constructs are intricately related and that changes in one of them are likely to elicit changes in the others. In particular, we have clarified that starting degrees – or initial degrees of formalization and trust – have disproportionate impacts on the evolution of collaborative relationships. We have also explicated that very low and very high levels of formalization and trust are probably less conducive to interorganizational

performance than intermediate levels. Jointly, these observations signal to managers that it is of uttermost importance to establish intermediate degrees of formalization and trust in interorganizational relationships quickly, so as to prevent the development of self-reinforcing cycles of trust-deterioration and formalism (see theme five). Sixth, it appeared that formalization is only one of a range of mechanisms that can be deployed to achieve coordination, control and possibly other functions of formalization. We therefore recommend managers to consider their full array of governance options when making decisions on formalization. Furthermore, they have to be aware of the fact that some governance mechanisms are more conducive to particular sets of firm-level and transaction or relational level factors than others, and that they enable or constrain the use of other governance mechanisms (see theme six).

If we consider the managerial implications of our study across the six themes, we can say the following. First, formalization appears to require more managerial efforts than just the codification and enforcement of outcomes and activities in contracts, rules and procedures. It also entails a need for investing in information processing and sensemaking, and it requires managerial attention so that the tensions between formalization's functions and its dysfunctions can be addressed (see theme one and theme three). Second, as formalization has multiple functions that are not only linked to formalization as an outcome, but also to formalization as a process (see chapter three and theme two), managers may have to pay more attention to how they shape and attenuate the process of formalization. The degree to which managers standardize this process, for example, may have significant consequences for the performance implications of formalization (see theme four). Although parties utilize comparable contracts, rules and procedures in similar relationships, the processes that have led up to these formalities may differ, leading to other effects on interorganizational performance. As Simons (1990, 1995) has proclaimed, managers may therefore have to pay more attention to the character of the formalization process itself. Third, formalization does not stand on itself, but appears to be intertwined with other forms of governance, such as trust and partner selection (see themes five and six). This indicates that practitioners may need to consider entire governance systems or governance trajectories when thinking about formalization in their collaborative relationships.

Managerial implications across themes

Formalization requires information processing and sensemaking efforts, and managerial attention for the tensions between its functions and dysfunctions.

As formalization has multiple functions that are not only linked to formalization as an outcome, but also to formalization as a process, managers have to pay more attention to how they shape and attenuate the process of formalization.

Formalization is intertwined with other forms of governance, and practitioners may need to consider entire governance systems or governance trajectories when thinking about how to govern their collaborative relationships.

To summarize, we believe that managers should consider our entire research framework when contemplating on how to govern their relationships (see Figure 10.2). They could proceed according to the following steps.

- (1) Identify the *needs* for coordination, control, legitimacy, and sensegiving and sensemaking in the relationship (see theme two).
- (2) Identify through which mechanisms these needs can be fulfilled (see theme five and theme six).
- (3) Identify whether there is a gap between the need for formalization and the *ability* to do so. If a gap exists, think of ways in which information can be processed and sensemaking can be facilitated, so that uncertainty and ambiguity are reduced (see theme one).
- (4) Consider how the formalization process should look like. Think, for example, of the persons that should be involved in the process, and assess whether the process should be standardized or not (see theme four).
- (5) Initiate the formalization process, but make sure that possible tensions between its functions and its dysfunctions are managed (see theme three).
- (6) Attempt to establish intermediate degrees of trust and formalization at the beginning of relationships. Then assess and monitor whether self-reinforcing spirals of trust-deterioration and formalism do not occur (see theme five).
- (7) Finally, continually reassess the previous six steps to make sure that: (a) the degree of formalization is appropriate for your needs; (b) there are no mechanisms that could fulfill those needs better; (c) gaps between the need and the ability to formalize are reduced; (d) attributes of the formalization process fit your needs; (e) tensions between formalization's functions and dysfunctions do not hamper interorganizational performance; and (f) changes in the degrees of trust and formalization influence each other, and interorganizational performance favorably.

10.4 Limitations and future research

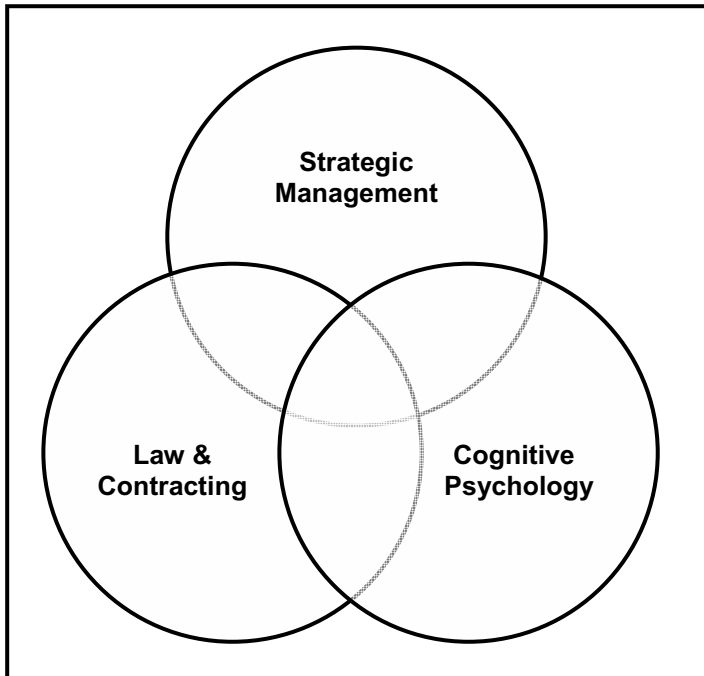
In interpreting this study, some caveats have to be kept in mind, which may be addressed in future research. The first limitation of our study is that each of the six themes in our framework has been investigated separately. Some of these themes were treated conceptually (themes two and five), while others have been investigated by means of a case study (theme three), or a survey (themes one, four and six). Although we believe that this approach has been fundamental to the development of an integrative perspective on the role of formalization in interorganizational relationships, we are also aware of the fact that various parts of the framework have not been empirically tested yet. We believe that future research should include further empirical testing so that the relevance and validity of various parts of our framework can be assessed. An experimental research approach may offer a high potential here, as it: (1) guarantees variation in certain factors through manipulation; (2) limits idiosyncrasies or variation due to external factors; (3) allows researchers to use multiple means to capture the values for the variables they are interested in and to assess the relationships between those variables, including observations, surveys and interviews; (4) enables researchers

to capture dynamics; and (5) allows them to test our entire framework in a single study. The latter is almost impossible through any other method of inquiry. In future research, experiments could be designed that enable a comparison between various collaborative projects, each with distinct relational and sub-group characteristics, initial degrees of formalization and trust, et cetera. Researchers can ask participants in these experiments why they apply certain degrees of formalization, referring to both their needs and their abilities to formalize (theme one). They can also have participants rate the degree to which formalization fulfills any of the four functions distinguished in our study (theme two). They may further develop several measures of collaborative performance, and ask participants in the experiment why they think they have performed better or worse than other groups (themes two and three). In addition, they may code and analyze scripts that capture collaborative dynamics in order to find out how leaders (e.g. managers) attempt to reduce gaps between the need and the ability to formalize, and how they cope with tensions between the functions and the dysfunctions of formalization (theme one and three). Moreover, researchers could manipulate each of the collaborative group's activities by introducing standard solutions for solving tasks (theme four). In addition, they can distinguish several rounds of cooperation, after which they measure how trust, formalization and interorganizational performance evolve (theme five). Finally, they can offer participants other means to achieve the functions that we attributed to formalization, and assess when managers use these means, why they do it and how it influences formalization (theme six).

A second limitation of our study concerns the extent to which we have capitalized on our own definition and typology of formalization. In chapter three, we defined formalization as the *process* of codifying and enforcing inputs, outputs and activities (Ouchi, 1979), and the *outcomes* of this process in the form of contracts, rules, standard policies, procedures and regulations (Hage and Aiken, 1966). We also distinguished three attributes of formalization, being (1) the degree of formalization that is applied (Makhija and Ganesh, 1997), (2) the extent to which it pertains to inputs and outcomes, or to processes (e.g. Ouchi, 1979; Koza and Lewin, 1998), and (3) its enabling or coercive character (e.g. see Adler and Borys, 1996). Although we have emphasized different parts of this definition and typology throughout our study, we have not used it as much and as explicitly as we could have done. The distinction between processes and outcomes of formalization, for example, was highly evident in theme four, where we distinguished between standard contracts (formalization as an outcome) and standardized negotiation and contracting procedures (formalization as a process), but it was not made explicit in many of the other themes. It also emanated in theme three, where alliance managers used the distinction to cope with the tensions arising from the co-existence of the functions and dysfunctions of formalization. Although these examples indicate the significance of our definition and typology of formalization, we believe that future research could benefit from using them more proactively. By doing so, researchers could even draw more refined and detailed pictures of the role of formalization in interorganizational relationships.

A third limitation, and in our view one of the major opportunities for future research, concerns the extent to which we have focused on aspects of formalization that have the potential to bridge disciplines of strategic management, law and contracting, and cognitive psychology (see Figure 10.3).

FIGURE 10.3
Major opportunities for future research



In this study, examples already abound. Information processing, sensemaking, mindfulness and trust, for example, are concepts that have their roots in cognitive psychology, but which have been applied here to study management processes (see themes one, two, four, and five). Similarly, in theme four, contract standardization (a topic in the law and contracting literature), has been connected to mindlessness (a concept stemming from cognitive psychology) and to the governance of interorganizational relationships (an issue in the strategic management literature). However, this thesis is still limited in the extent to which it has explored the cross-sections between these three disciplines. We suggest that parts of Figure 10.3 in which the literatures show a potential for convergence offer highly promising avenues for further research. An example of such an area consists of the reasons and causes of contract incompleteness (see Eggleston et al., 2000). Whereas most of the law and contracting literature presumes that parties to a relationship record and enforce outcomes and activities in a way that

minimizes transaction costs, cognitive psychology suggests that managers may not be able to do so, due to, among others, bounded rationality, memory problems, and fears of upsetting a partner. At the same time, the strategic management literature suggests that partners withhold information from contracts on purpose, as they may use information-asymmetry to capture most of the value that is being created in a relationship. Another example in which the three disciplines come together revolves around the utilization of the law and legal instruments to develop new business strategies. As Bagley (2005) convincingly promulgates, organizations may use changes in these areas proactively. Managerial cognition, in particular managers' legal astuteness, or their ability to recognize and pursue the opportunities that arise from legal changes, may be a key element here (Bagley, 2005). In summary, we believe that this study has contributed to bridging the literatures on strategic management, law and contracting, and cognitive psychology, but we also think that there are still many promising opportunities that could enrich our research framework and that deserve to be addressed in future research. These examples elucidate that the role of formalization in interorganizational relationships continues to merit substantial academic attention.

10.5 Conclusion

In this chapter, we have discussed the findings and implications emanating from our study the role of formalization in interorganizational relationships. We have elaborated on six research themes, each associated with their own research questions and focusing on a particular aspect of the research problem. We presented the key findings emanating from our study, the theoretical and practical implications associated with our findings, and the limitations of our investigations from which opportunities for future research ensued. A red thread that has been weaving its way through this discussion is that formalization is a multifaceted concept, which deserves to be investigated from multiple perspectives. Researchers studying formalization and managers putting it into practice should clearly identify which aspect of formalization they are dealing with, and they have to prevent placing too much emphasis on one perspective at the cost of others (Heiman and Nickerson, 2004). We are confident that the integrative framework that we have presented in this study and our elaboration on each of its components in the six research themes will offer them a fertile basis from which to develop and enrich their thinking.

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DUTCH SUMMARY / NEDERLANDSE SAMENVATTING

Interorganisatorische samenwerkingsverbanden – waaronder allianties, joint ventures, leveranciers- en outsourcingsrelaties – zijn van toenemend belang voor het concurrentievermogen van ondernemingen. Deze samenwerkingsverbanden krijgen daarom steeds meer aandacht van onderzoekers en managers. Hoewel het belang van interorganisatorische relaties algemeen wordt onderkend, blijkt ook dat managers het moeilijk vinden om dergelijke relaties te managen (Madhok, 1995), getuige de hoge faalpercentages die worden toegedicht aan dergelijke relaties (Harrigan, 1988; Parkhe, 1993a). Ernst (2003) schat dat ongeveer de helft van de allianties faalt door beheersingsproblemen. Deze bewering wordt ondersteund door studies van McKinsey (Ernst et al., 2003) en Accenture (2003). In overeenstemming hiermee, suggereren Park en Ungson (2001) dat de problemen die tot falen of slechte interorganisatorische prestaties leiden deels zijn te voorkomen door geschikte beheersingsmechanismen toe te passen.

In lijn hiermee hebben verscheidene onderzoekers gewezen op het belang van de beheersing van interorganisatorische relaties (Dyer en Singh, 1998; Ireland et al., 2002; Madhok, 2002; Ring, 2002; Takeishi, 2001). Dyer en Singh (1998) geven bijvoorbeeld aan dat een effectieve beheersing van interorganisatorische relaties kan zorgen voor een interorganisatorisch concurrentievoordeel door investeringen in relatie-specifieke midelen, het delen van kennis, of het combineren van complementaire middelen te faciliteren. Dergelijke claims wijzen op het belang van een beter begrip van interorganisatorische beheersing (Olk en Elvira, 2001; Osborn en Hagedoorn, 1997) en meer onderzoek naar interorganisatorisch management (Hutt et al., 2000; Ireland et al., 2002). Bijdragen in dit onderzoeksveld kunnen leiden tot een afname van interorganisatorische problemen (Barringer en Harrison, 2000). Verscheidene auteurs hebben specifiek gevraagd om een integraal beeld van de rol van formalisering – voorlopig gedefinieerd als het bestaan en de toepassing van contracten, regels en procedures – in interorganisatorische relaties (zie bijvoorbeeld Sobrero en Schrader (1998), Stinchcombe (2001) en Thatcher (2004) in Tabel 1.2). De voorgaande overwegingen hebben geleid tot de volgende onderzoeksvraag: *Welke rol speelt formalisering in interorganisatorische relaties?*

Een visuele representatie van dit onderzoeksprobleem is weergegeven in een onderzoeksraamwerk (zie Figuur 1.4). Dit raamwerk bouwt op de in de literatuur dominante perspectieven op formalisering, welke focussen op functies als coördinatie en controle (zie bijvoorbeeld Gulati en Singh, 1998; Madhok, 2002). Vanuit deze perspectieven wordt onderzoek verricht naar ofwel de antecedenten van formalisering, ofwel de relatie tussen formalisering en interorganisatorische prestaties (Anderson en Dekker, 2006; Sobrero en Schrader, 1998; Stinchcombe, 2001). Hoewel eerder onderzoek een belangrijke bijdrage heeft geleverd aan het verkrijgen van inzicht in de rol van formalisering in interorganisatorische relaties, ontbreekt het in de literatuur tot op heden aan een integraal beeld. Met het oog op de ontwikkeling van een dergelijk beeld hebben we zes onderzoeksthema's gedefinieerd, elk gericht op de beantwoording van een aantal onderzoeksvragen. Hieronder schetsen we kort de onderzoeksvragen behorende bij de zes thema's,

de belangrijkste bevindingen per thema en de theoretische en praktische implicaties van ieder thema afzonderlijk. Vervolgens gaan we in op overkoepelende theoretische en praktische implicaties van het gehele onderzoek.

Thema één – de behoefte versus de mogelijkheid tot formalisering

In dit thema worden tegengestelde bevindingen in de literatuur betreffende de invloed van antecedenten op formalisering onderzocht. We vooronderstellen dat, net als bij partner selectie (Ahuja, 2000) en leren (Inkpen, 2000), inspanningen gericht op interorganisatorische beheersing enerzijds afhankelijk zijn van de behoeften en intenties van partijen (*need to formalize*) en anderzijds van de mogelijkheden die deelnemers aan interorganisatorische relaties hebben om uitkomsten en processen te coördineren en te controleren (*ability to formalize*). Het lijkt erop dat bestaande argumenten voor relaties tussen antecedenten en formalisering uitgaan van ofwel de behoefte om te formaliseren, ofwel de mogelijkheid om dit te doen, maar niet van beide (zie Gerwin, 2004; Kirsch, 1997). Dit roept de volgende vragen op.

OV1: In welke mate bestaan relaties tussen antecedenten en formalisering uit tegengestelde krachten?

OV2: Hoe beïnvloeden discrepanties tussen de behoefte en de mogelijkheid tot formaliseren de mate van formalisering in interorganisatorische relaties?

Bevindingen. Onze resultaten gaven aan dat hoge investeringen in relatie-specifieke middelen, een hoge mate van interorganisatorische complexiteit, samenwerking met een bekende partner en samenwerking met kleine afnemers gepaard gaan met een hoge behoefte en een beperkte mogelijkheid tot formalisering. Met behulp van de begrippen “informatieverwerking” (zie bijvoorbeeld Galbraith, 1973, 1977) en “zingeving” (Weick, 1979, 1995, 2001) verklaarden we vervolgens hoe deelnemers aan interorganisatorische relaties omgaan met de resulterende impasse. De spanning tussen de behoefte en de mogelijkheid tot formaliseren zorgt ervoor dat partners inspanningen doen om informatie te vergaren en te verwerken en betekenis te geven aan relaties. Deze inspanningen zijn hoger naarmate de behoefte en de mogelijkheid tot formaliseren een sterkere discrepantie vertonen.

Theoretische en praktische implicaties. Op theoretisch niveau betekenen onze resultaten dat onderzoek naar formalisering zowel de behoefte tot formaliseren als de mogelijkheid tot formaliseren dient te beschouwen, evenals de mate waarin en de wijze waarop managers zich inspannen om de kloof tussen beide te dichten. Voor managers bevestigen onze bevindingen dat de relaties die het meest nuttig zijn waarschijnlijk ook het meest meoilyk te managen zijn (Accenture, 2003). Dit betekent dat het in sommige gevallen misschien beter is om minder complexe relaties te initiëren, of om modulaire relaties met nauwe interfaces tussen organisaties op te zetten. In meer geavanceerde relaties dient geïnvesteerd te worden in informatie verwerking en zingeving, zodat formalisering mogelijk wordt.

Thema twee – functies van formalisering

Het tweede thema is voortgekomen uit de observatie dat een beter begrip van de *redenen* die partijen kunnen hebben om contracten, regels en procedures te gebruiken cruciaal is voor een goede beschrijving van de functionering van samenwerkingsverbanden (Masten en Saussier, 2002). We signaleren dat het merendeel van de studies naar formalisering ervan uitgaat dat contracten, regels en procedures ingezet worden als middel om processen en uitkomsten te coördineren, te controleren en/of te legitimeren (zie bijvoorbeeld Gulati en Singh, 1998; Kale et al., 2002; Madhok, 2002). Ze besteden weinig aandacht aan mogelijke andere functies van formalisering, ondanks het feit dat verschillende auteurs hebben aangegeven dat er alternatieve verklaringen voor formele structuren en processen nodig zijn (Hatch, 1999; Meyer en Rowan, 1977; Simons, 1990, 1995). In dit thema onderscheiden we naast de coördinatie-, controle- en legitimitetsfunctie van formalisering een zogenaamde “sensegiving en sensemaking functie”. We vooronderstellen dat deze vier functies van formalisering naast elkaar kunnen bestaan, maar signaleren dat er onduidelijkheid bestaat over de wijze waarop deze functies met elkaar samenhangen (zie Madhok, 2002), op welke wijze ze interorganisatorische prestaties beïnvloeden en in welke contexten en voor welke ontwikkelingsfasen van relaties elk van deze functies het meest belangrijk is. We hebben deze overwegingen gevat in de volgende onderzoeksvragen.

OV3: Wat zijn de functies van formalisering?

OV4: Hoe hangen de functies van formalisering met elkaar samen?

OV5: Hoe verhouden ze zich tot interorganisatorische prestaties?

OV6: Wat is het relatieve belang van de diverse functies van formalisering in verschillende fasen van interorganisatorische ontwikkeling en in diverse collaboratieve contexten?

Bevindingen. In dit thema beschreven we hoe formalisering kan bijdragen aan “sensegiving en sensemaking”, een functie van formalisering die tot op heden weinig aandacht heeft gekregen in de managementliteratuur (voor uitzonderingen, zie bijvoorbeeld Ariño en Ring, 2004; Ring en Van de Ven, 1989, 1994). We lieten zien dat formalisering stakeholders helpt om zin geven aan de relaties waar ze bij betrokken zijn en aan de collaboratieve omgevingen waarin deze relaties ingebed zijn. We suggereerden bovendien dat formalisering ten behoeve van “sensegiving en sensemaking” belangrijker is in het begin van interorganisatorische relaties en in exploratieve contexten. We verwachtten daarnaast dat andere functies van formalisering beter vervuld kunnen worden naarmate “sensegiving en sensemaking” heeft plaats gevonden en dat de relatie tussen deze functie van formalisering en interorganisatorische prestaties afwijkt van de relatie tussen andere functies van formalisering en prestaties.

Theoretische en praktische implicaties. Deze studie complementeert de in de literatuur dominante perspectieven op de functies van formalisering met een beeld van formalisering als een middel om “sensegiving en sensemaking” te bewerkstelligen. Dit beeld pleit voor meer aandacht voor de processen waaruit formaliteiten ontstaan (zie ook Langley, 1988; Mintzberg, 1994) en voor een grotere nadruk op vormen van formalisering, waarin de ontwikkeling van begrip (Zollo en Singh, 2004) en betekenis (Giddens, 1984) een meer centrale positie innemen (zie ook Adler en Borys, 1996; Zollo en Winter, 2002). Ons onderzoek suggereert bovendien dat formalisering ten behoeve van “sensegiving en sensemaking” prevaleert in interorganisatorische relaties gekarakteriseerd door onzekerheid, ambiguïteit en vernieuwing. Dit vraagt om nader onderzoek, omdat het in schril contrast staat met literatuur waarin wordt voorspeld dat de mate van formalisering noodzakelijkerwijs laag is in situaties waarin onzekerheid en beperkte meetbaarheid en beschrijfbaarheid van processen en uitkomsten bestaan (Galbraith, 1973; Lassar en Kerr, 1996; Ouchi, 1979; Poppo en Zenger, 2002; Shane, 1996; Williamson, 1985).

Thema drie – dualiteit & dialectische spanningen

In thema twee zijn het duale karakter van formalisering – voortkomend uit de coëxistentie van haar functies en disfuncties – en de dialectische spanningen die hieruit voortvloeien onderwerp van discussie. We omarmen het idee dat spanningen niet altijd kunnen worden opgelost (Ring en Van de Ven, 1989), maar moeten worden gemanaged (Huxham en Beech, 2003). We benadrukken daarom de rol van “managerial choice” bij formaliseringsbeslissingen (Child, 1997) en onderzoeken hoe managers kunnen omgaan met de spanningen tussen de functies en disfuncties van formalisering (zie Das en Teng, 2000; De Rond, 2003; De Rond en Bouchiki, 2004). We formuleren de volgende onderzoeksvraag:

OV7: Hoe gaan managers van interorganisatorische relaties om met de spanningen voortkomend uit de coëxistentie van functies en disfuncties die geassocieerd worden met formalisering?

Bevindingen. Door middel van een literatuuronderzoek en een case studie van een crossindustriële strategische alliantie toonden we aan dat een groot aantal functies en disfuncties gerelateerd aan het gebruik en de ontwikkeling van contracten, regels en procedures naast elkaar kunnen bestaan. We lieten zien dat alliantie managers op tenminste drie wijzen omgaan met de dialectische spanningen die hieruit voortkomen: (1) ze benadrukken afwisselend de mate waarin de ene dan wel de partner de behoefte tot formalisering heeft in hun communicatie naar deelnemers aan interorganisatorische relaties; (2) ze proberen het door hen ingestelde of nagestreefde niveau van formalisering te rechtvaardigen door te refereren naar factoren die zij ogenschijnlijk niet zelf kunnen beïnvloeden; en (3) ze passen semi-structuren toe, waarin *ofwel* de formalisering van uitkomsten *ofwel* de formalisering van processen wordt benadrukt. Deze bevindingen illustreren dat de introductie van een dialectisch perspectief op interorganisatorische beheersing een veelbelovende aanvulling

vormt op coördinatie- en controlebenaderingen in onderzoek naar de rol van formalisering in interorganisatorische relaties.

Theoretische en praktische implicaties. Het door ons beschreven dialectisch perspectief op formalisering in interorganisatorische relaties benadrukt dat managers zich niet alleen bezighouden met het nemen van de “juiste” beheersingsbeslissingen, maar ook en misschien voornamelijk met het managen van de hier uit voortvloeiende spanningen. Het toont aan dat onderzoek waarin “de manager” wordt teruggebracht in interorganisatorische beheersingsvraagstukken tot waardevolle inzichten kan leiden. Deze studie laat bovendien zien dat managers die zich bewust zijn van de talloze functies en disfuncties waardoor formalisering interorganisatorische prestaties beïnvloedt, zich in een betere positie bevinden om de spanningen te onderkennen die voortvloeien uit formalisering en beter met deze spanningen om moeten kunnen gaan. Deze managers kiezen niet tussen “controle” en “autonomie”, maar appreciëren het feit dat formalisering een breder scala van functies en disfuncties met zich meebrengt. Ze zijn mogelijk in staat gelijktijdig tegengestelde perspectieven te hanteren en te ontwikkelen (Eisenhardt, 2000) en beperken de tendens tot overmatige rationalisering van beslissingen betreffende de structuur en structurering van interorganisatorische relaties.

Thema vier – contractstandaardisering

In het vierde thema merken we op dat het gebruik van standaardcontracten en standaardprocedures tijdens onderhandelingen en contractbesprekingen wijdverspreid is (Korobkin, 2003), maar ook dat de invloed van standaardisering op interorganisatorische samenwerkingsverbanden grotendeels onontgonnen terrein is voor onderzoekers. Om een beeld te krijgen van de invloed van standaardisering op de rol van formalisering in interorganisatorische relaties, besteden we aandacht aan de volgende onderzoeksvragen.

OV8: Wat zijn de voor- en nadelen van het gebruik van standaardcontracten in interorganisatorische relaties?

OV9: Wat is de invloed van de introductie van standaardprocedures voor onderhandelingen en contract besprekingen op het generieke onderzoeksmodel (gebaseerd op coördinatie- en controle perspectieven) voor studies naar formalisering in interorganisatorische relaties?

Bevindingen. Door middel van een literatuuroverzicht toonden we aan dat de motieven of redenen voor standaardisering samenhangen met: de efficiëntie, de snelheid en de robuustheid van transacties; de exploitatie van informatie asymmetrie; het voorkomen van onbedoelde signalen; de legitimiteit die wordt toegekend aan relaties; de mate waarin eenduidige interpretatie van formaliteiten mogelijk is; en het bestaan van netwerk-effecten. De nadelen van standaardisering bestaan uit de lage mate van contractuele specificiteit en het beperkte potentieel voor de ontwikkeling van wederzijdse verwachtingen en de creatie van gemeenschappelijk begrip. We onderzochten vervolgens de assumptie

dat het toepassen van standaardprocedures samengaat met een verlaagde mate van zorgvuldigheid, waakzaamheid en oplettendheid (Weick, 1979; 1995). Met behulp van analyses op een steekproef van 911 klant-leverancier-relaties laten we zien dat de associaties tussen formalisering, haar meest algemene antecedenten en interorganisatorische prestaties worden afgezwakt door een hogere mate van standaardisering van interorganisatorische onderhandeling- en contracteringsprocessen. Standaardisering kan dus leiden tot de-contextualisatie, een inadequate communicatie van toezeggingen, rechten en plichten (Goetz en Scott, 1985) en beperkte mogelijkheden van partijen om een grotere “transactie-taart” te realiseren (Hill en King, 2004: 890). Het gebruik van standaardprocedures resulteert hiermee mogelijk in een beperkte staat van “mindfulness” bij contractpartijen, waardoor het nut van formalisering sterk wordt gereduceerd.

Theoretische en praktische implicaties. De bevindingen impliceren dat studies naar interorganisatorische beheersing zowel gericht zouden moeten zijn op formalisering als een uitkomst alswel op formalisering als een proces (zie ook hoofdstuk twee; Chia, 1997: 703; Hatch, 1999: 82). We verwachten dat dergelijke studies kunnen verklaren waarom ‘human beings can possess high intelligence and yet evidence frequent lack of intellectual awareness when making decisions’ (Sharps en Martin, 2002: 273) en waarom contracten over het algemeen eenvoudig zijn, terwijl voorspellingen vanuit de theorie aangeven dat ze complex zouden moeten zijn (Eggleston et al., 2000). Op praktisch niveau betekenen onze bevindingen dat de negatieve effecten van standaardisering moeten worden gecompenseerd door bijvoorbeeld oplettende en waakzame medewerkers aan te trekken, of door “contracting capabilities” te ontwikkelen (analoog aan “alliance capabilities”; zie Kale et al., 2002), waarbij organisaties ervaringen uit eerdere onderhandeling- en contracteringsprocessen exploiteren in toekomstige relaties (zie Mayer en Argyres, 2004). Deze oplossing onderschrijft het belang dat wordt toegeschreven aan het management van interorganisatorische relaties op portfolio niveau (Heide, 2003; Wuyts et al., 2004). Ten slotte kunnen partijen “sensemaking triggers” in contracten en contractbesprekingen inbouwen, zodat meer doordachte, creatieve en flexibele “states of mind” worden opgeroepen (Burgoon et al., 2000: 112). Sensemaking triggers “dwingen” managers om na te denken over de onderliggende logica van relaties, de risico’s, kosten, investeringen en opbrengsten van samenwerkingsverbanden en de mogelijkheden om prestaties te verhogen (Vlaar et al., 2005).

Thema vijf – formele versus relationele beheersing

In thema vijf richten we ons op de wisselwerking tussen formalisering en vertrouwen. Onderzoeksresultaten suggereren dat er een behoefte is om de relatie tussen formele en relationele beheersing beter te beschrijven en voorspellen (Poppo en Zenger, 2002). Er bestaat voornamelijk onduidelijkheid met betrekking tot de evolutie van formalisering en vertrouwen gedurende samenwerkingsverbanden (De Wever et al., 2006; Ferrin et al., 2005; Inkpen en Curall, 2004; Klein Woolthuis et al., 2005; Serva et al., 2005). In dit thema staat daarom de volgende onderzoeksvraag centraal.

RQ10: Hoe ontwikkelen formalisering en vertrouwen zich in interorganisatorische relaties?

Bevindingen. In dit thema hebben we een integraal perspectief ontwikkeld op de evolutie van formele en relationele beheersing in interorganisatorische relaties. We beweerden dat intermediaire niveaus van formalisering en vertrouwen een positievere invloed uitoefenen op interorganisatorische prestaties dan extreme waarden, omdat de laatste chaos, achterdocht, rigiditeit en naïviteit met zich mee kunnen brengen. We suggereerden bovendien dat de aanbevolen mate van formalisering en vertrouwen wisselt voor interorganisatorische met uiteenlopende transactiekarakteristieken en voor relaties in verschillende contexten. Vervolgens gaven we aan hoe beide mechanismen vanuit een dynamisch perspectief zowel als substituut (als een van beide toeneemt, neemt de behoefte aan de ander af) alswel als complement kunnen fungeren (als een van beide toeneemt, wordt de mogelijkheid om de ander te ontwikkelen vergroot). Daarna introduceerden we een raamwerk waarin de ontwikkeling van vertrouwen en formalisering is beschreven (Zie Figuur 8.4). We suggereerden dat deze ontwikkeling grotendeels afhankelijk is van de initiële niveaus van formalisering en vertrouwen in relaties (zie ook Ferrin et al., 2005; Klein Woolthuis et al., 2005) en van de interpretaties die deelnemers aan interorganisatorische relaties geven aan formaliseringsacties door hun partners.

Theoretische en praktische implicaties. De argumenten die naar voren zijn gebracht in deze studie tonen allereerst aan dat dat een integraal perspectief op de evolutie van formele en relationele beheersing in interorganisatorische relaties bij kan dragen aan ons begrip van beheersingsvraagstukken (zie ook Bachmann, 1998). De ontwikkeling en de relaties tussen formalisering, vertrouwen en interorganisatorische prestaties zoals beschreven in dit thema blijken immers veel gecompliceerder en verfijnder te zijn dan de voorstelling die er vaak van wordt gegeven in de literatuur. De studie wijst er ook op dat we ervoor moeten waken dat vertrouwen en formalisering doelen op zich worden. We kunnen een hoge mate van vertrouwen ambiëren in onze relaties, maar uiteindelijk zijn het de interorganisatorische prestaties die er daadwerkelijk toe doen.

Thema zes – beheersingstrajecten

In thema zes gaan we verder in op relaties tussen beheersingsmechanismen. Hoewel empirische onderzoeken zich vaak op één of slechts enkele beheersingsmechanismen concentreren (Geringer en Hébert, 1991a; Kirsch, 1997), zijn er dikwijls meerdere mechanismen nodig om waardecreatie te realiseren (Reuer, 1999). Deze beheersingsmechanismen lijken bovendien onderling met elkaar verbonden te zijn (Klein, 2002). De kloof tussen de veelheid aan beheersingsbeslissingen die worden gemaakt in interorganisatorische relaties en de beperkte aandacht die onderzoekers geven aan de relaties tussen deze beslissingen leidt tot onze laatste onderzoeksvraag.

OV11: In welke mate zijn formalisering en andere beheersingsbeslissingen in interorganisatorische relaties aan elkaar gerelateerd?

Bevindingen. Om deze vraag te onderzoeken introduceerden we het concept “governance trajectories.” Dergelijke trajecten bestaan uit meerdere aan elkaar gerelateerde beheersingsbeslissingen, welke beïnvloed worden door verschillende sets van antecedenten. Resultaten van onze analyses op een steekproef van 911 buyer-supplier relaties geven aan dat managers proberen om relaties op verschillende manieren te beheersen gedurende opeenvolgende ontwikkelingsfasen en dat de beheersingsbeslissingen die ze in het begin van een relatie nemen invloed hebben op latere beslissingen. Bovendien blijkt dat diverse karakteristieken van de relatie, de partners en de collaboratieve context het gebruik van beheersingsmechanismen op diverse wijzen beïnvloeden.

Theoretische en praktische implicaties. Onze bevindingen tonen aan dat de inspanningen die managers doen om coördinatie, controle, legitimiteit en zingeving te bewerkstelligen in interorganisatorische relaties gelijktijdig onderzoek vereisen naar meerdere beheersingsmechanismen en de connecties tussen deze mechanismen (zie bijvoorbeeld ook thema vijf). Managementimplicaties betreffen voornamelijk het bewustzijn bij managers dat ze de beschikking hebben over een groot aantal mechanismen om interorganisatorische relaties te beheersen en dat beheersingsbeslissingen in verschillende fasen van interorganisatorische relaties elkaar beïnvloeden. Lagere selectie-inspanningen worden bijvoorbeeld geassocieerd met minder intense onderhandelingen, het gebruik van standaardcontracten in plaats van contractueel maatwerk en een lager niveau van contractcompleetheid. Een integraal beeld – in de vorm van het concept beheersingstrajecten – stelt managers in staat beheersingsbeslissingen in een groter kader te plaatsen.

Thema-overstijgende theoretische implicaties van de studie

De studie heeft ook verschillende thema-overstijgende theoretische implicaties. Thema één en thema drie geven aan dat “de manager dient te worden teruggebracht” in onderzoek naar interorganisatorische beheersing. In thema één vonden we bijvoorbeeld dat managers de mate kunnen beïnvloeden waarin spanningen tussen de behoefte en de mogelijkheid tot formaliseren interorganisatorische prestaties beperken. In thema drie lieten we zien hoe managers omgaan met de spanningen tussen de functies en de disfuncties van formalisering. Onze bevindingen impliceren dat de aandacht van onderzoekers niet alleen zou moeten worden gericht op de “juiste” mate van formalisering – gezien de karakteristieken van relaties en organisaties (Foss en Foss, 2005; Madhok, 2002; Williamson, 1985, 1991) – maar ook op de wijze waarop *managers* ervoor zorgen dat formalisering een positieve invloed heeft op interorganisatorische prestaties.

Een tweede theoretische implicatie betreft de functies van formalisering in interorganisatorische relaties. Waar sommige onderzoekers vragen om meer systematische aandacht voor de coördinatie functie van formalisering (e.g. Carson et al., 2006: 36; see also Mayer en Argyres, 2004), wijst ons onderzoek op de noodzaak om maar liefst vier hoofdfuncties van formalisering te bestuderen. Door de coördinatie-, controle-, legitimiteit- en zingeving functies van formalisering

expliciet van elkaar te onderscheiden, zullen onderzoekers beter in staat zijn om betekenisvolle conclusies te trekken over de rol van formalisering in interorganisatorische relaties. Thema vier geeft aan dat attributen van het formaliseringsproces, zoals standaardisering, van invloed kunnen zijn op deze functies en dat onderzoekers zich moeten afvragen of formalisering als uitkomst, of formalisering als proces de grootste bijdrage aan interorganisatorische prestaties levert (zie ook hoofdstuk drie).

Een derde theoretische implicatie betreft de wisselwerking tussen formalisering en andere beheersingsmechanismen. In thema vijf en zes hebben we laten zien dat formalisering nauw verbonden is met andere beheersingsmechanismen en dat het daar moeilijk van is te isoleren. Veranderingen in formalisering kunnen bijvoorbeeld het gevolg zijn van een reductie of toename van vertrouwen (thema vijf), maar ook van verschillende niveaus van partner selectie (thema zes). De complexe relaties tussen formalisering en andere beheersingsmechanismen zorgen ervoor dat het effect van formalisering op interorganisatorische prestaties moeilijk is vast te stellen. Wanneer onderzoekers bijvoorbeeld een positieve relatie vinden tussen formalisering en prestaties, dan kan dit bijvoorbeeld ook het gevolg zijn van investeringen in informatieverwerking en zingeving (thema 1), hoge niveaus van vertrouwen die formalisering hebben mogelijk gemaakt (thema vijf) en relatief grote selectie en onderhandelingsinspanningen (thema zes). Omdat het moeilijk is om gehele beheersingstrajecten in analyses mee te nemen en vanwege het feit dat de evolutie van formalisering, vertrouwen en andere beheersingsmechanismen lastig in kaart te brengen is, bestaat er het gevaar dat onderzoek naar de effecten van formalisering op interorganisatorische prestaties leidt tot schijnbevindingen, verkeerde interpretaties en foutieve aanbevelingen.

Een vierde theoretische implicatie van het onderzoek betreft de waarde die moet worden gehecht aan onderzoek waarin de mate van formalisering wordt voorgesteld als een functie van ondernemings- en transactie-karakteristieken. De bevindingen in alle zes de thema's geven aan dat prescriptie op basis van generieke modellen uit de literatuur – modellen waarin antecedenten formalisering beïnvloeden en waarin formalisering vervolgens interorganisatorische prestaties beïnvloedt – dienen met voorzichtigheid te worden betracht. Onze resultaten trekken de houdbaarheid van dergelijke modellen in twijfel en laten zien dat hun normatieve waarde vaak zeer beperkt is (zie ook Ghoshal en Moran, 1996). De mate van formalisering is niet slechts afhankelijk van ondernemings- en transactie- of relationele karakteristieken, zoals voorspeld door bijvoorbeeld de transactiekosten theorie of agency theorie, maar is ook onderhevig aan: (1) variatie in de reactie van managers op discrepanties tussen de behoefte en de mogelijkheid tot formaliseren (thema één); (2) variatie in de functies die managers met formalisering wensen te vervullen (thema twee); (3) variatie in de vaardigheden van managers om de spanningen tussen functies en disfuncties van formalisering te managen (thema drie); (4) attributen van het formaliseringsproces die de sterkte van de associaties tussen antecedenten en formalisering beïnvloeden (thema vier); (5) de invloed van vertrouwen op formalisering, en vice

versa, gedurende de evolutie van samenwerkingsverbanden (thema vijf); en (6) de beschikbaarheid van andere beheersingsmechanismen (thema zes).

Een laatste theoretische implicatie betreft de loyaliteit van onderzoekers aan één of enkele theoretische en methodologische paradigma's. Wij geloven dat onze resultaten het startsein vormen voor meer onderzoek naar formalisering waarin de grenzen van theorieën en zelfs wetenschappelijke disciplines vervagen. Waar de theorieën en methoden in de verschillende onderzoeksthema's in eerste instantie misschien zijn gebaseerd op conflicterende assumpties en uitgangspunten, daar blijkt het gebruik van een veelheid aan perspectieven in ons onderzoek ook te leiden tot de inzichten verbonden met de zes onderzoeksthema's en Figuur 10.2. Deze studie toont daarmee aan dat een pluralistische onderzoeksaanpak in studies naar interorganisatorische beheersingsproblemen mogelijk tot rijkere en waarschijnlijk ook betekenisvollere inzichten met betrekking tot de rol van formalisering in interorganisatorische relaties leiden dan tot nu toe geschetst.

Praktische implicaties van de studie

Deze studie heeft ook verschillende praktische implicaties. Thema één impliceert dat formalisering over het algemeen vergezeld dient te gaan van inspanningen gericht op informatie verwerking en sensemaking. Dergelijke inspanningen verminderen de spanningen tussen een beperkte *mogelijkheid* om te formaliseren en een hoge *behoefte* aan formalisering, omdat ze onzekerheid en ambiguïteit reduceren en omdat ze ervoor zorgen dat partijen beter in staat zijn om aspecten van de relatie te vatten in formele documenten. Thema twee suggereert dat formalisering niet noodzakelijkerwijs dient als middel om coördinatie, controle, of legitimiteit te bewerkstelligen. Het functioneert ook als een middel om betekenis te geven aan interorganisatorische relaties en de context waarin deze zijn ingebed. Managers kunnen deze kennis gebruiken om hun motieven voor formalisering uit te leggen aan partners en personeel. Thema één en drie geven aan dat managers niet alleen aandacht moeten besteden aan het realiseren van de "juiste" mate van formalisering (Foss en Foss, 2005; Madhok, 2002; Williamson, 1985, 1991), maar ook en misschien wel voornamelijk met het managen van de spanningen die hiermee samenhangen. We adviseren managers om strategieën te ontwikkelen waarmee de mogelijkheden voor formalisering worden vergroot en waarmee de disfuncties van formalisering kunnen worden vermeden of worden gemanaged. Thema vijf impliceert dat managers de effecten van standaardisering en de geneigdheid tot het vertonen van "mindless" gedrag in interorganisatorische relaties dienen te onderkennen. De nadelen van standaardisering wijzen erop dat managers voorzichtig moeten zijn met standaardisering. Thema vijf suggereert dat het erg belangrijk is dat managers snel intermediaire niveaus van formalisering en vertrouwen opbouwen, zodat een afbrokkeling van vertrouwen en formalisme in de toekomst kan worden voorkomen. Thema zes geeft aan dat managers naast formalisering hun volledige pallet aan mogelijkheden om coördinatie, controle, legitimiteit of zingeving te bewerkstelligen dienen te beschouwen. Ze dienen daarin rekening te houden met het feit dat sommige beheersingsmechanismen meer geschikt zijn voor bepaalde karakteristieken van hun onderneming of de

relatie waarin ze participeren dan andere en dat de toepassing van sommige beheersingsmechanismen het gebruik van andere kan bevorderen of beperken.

Onze studie heeft ook enkele thema-overstijgende praktische implicaties. Ten eerste blijkt formalisering méér managementinspanningen te vergen dan de codificatie van verwachte uitkomsten en activiteiten in contracten, regels en procedures en de afdwinging hiervan. Om succesvol formalisering toe te passen, dienen managers ook investeringen te doen in activiteiten gericht op informatie verwerking en het geven van betekenis aan de relatie en de omgeving waarin deze is ingebed. Bovendien vereist formalisering continue aandacht van managers zodat spanningen tussen de functies en disfuncties van formalisering kunnen worden gemanaged. Ten tweede heeft formalisering meerdere functies, welke niet alleen verbonden zijn met formalisering als uitkomst, maar ook met formalisering als proces (zie hoofdstuk twee). Managers zouden derhalve meer aandacht moeten besteden aan de wijze waarop het formaliseringsproces plaats vindt en hoe dit proces beïnvloed wordt (zie ook Simons, 1990, 1995). Thema vier laat bijvoorbeeld zien dat de mate waarin dit proces wordt gestandaardiseerd significante consequenties kan hebben voor de invloed van formalisering op interorganisatorische prestaties. Ten derde blijkt uit thema vijf en zes dat formalisering niet op zichzelf staat, maar sterk verbonden is met andere beheersingsprocessen, zoals vertrouwen en partner selectie. Dit wijst erop dat managers gehele beheersingssystemen of beheersingstrajecten in ogenschouw moeten nemen als ze nadenken over de beheersing van hun relaties.

Limitaties en vervolgonderzoek

Bij de interpretatie van deze studie dienen enkele beperkingen te worden aangestipt, welke zouden kunnen worden opgepakt in vervolgonderzoek. De eerste beperking van onze studie is dat de zes thema's in ons raamwerk apart van elkaar zijn onderzocht. Sommige van deze thema's waren conceptueel van aard (thema's twee en vijf), terwijl anderen onderzocht zijn middels de case study methode (thema drie), of de survey methode (thema één, vier en zes). Hoewel we geloven dat deze aanpak fundamenteel is voor de ontwikkeling van een integraal beeld van de rol van formalisering in interorganisatorische relaties, beseffen we ook dat verschillende onderdelen van ons raamwerk nog empirisch getest dienen te worden. Een experimentele aanpak lijkt hiervoor heel geschikt. Een tweede beperking van deze studie betreft de mate waarin we gebruik hebben gemaakt van de definitie en typologie van formalisering zoals weergegeven in hoofdstuk twee. We definieerden formalisering als 'the *process* of codifying and enforcing inputs, outputs, and activities (Ouchi, 1979), and the *outcomes* of this process in the form of contracts, rules, standard policies, procedures and regulations (Hage en Aiken, 1966). We onderscheidden verder drie attributen van formalisering, zijnde: (1) de mate van formalisering (Makhija en Ganesh, 1997); (2) de mate waarin formalisering slaat op inputs en uitkomsten, of op processen (Ouchi, 1979; Koza en Lewin, 1998); en (3) het "enabling" of "coercive" karakter van formalisering (Adler en Borys, 1996). Hoewel de verschillende onderdelen van deze definitie en typologie naar voren zijn gekomen in deze studie, hebben we het nog niet zo expliciet en systematisch gebruikt als zou kunnen. We geloven dat

vervolgonderzoek zou kunnen profiteren van een meer pro-actief gebruik van onze definitie en typologie van formalisering. Dit zou kunnen leiden tot een nog verfijndere en gedetailleerde beschrijving van de rol van formalisering in interorganisatorische relaties.

Een derde beperking en naar onze mening één van de grootste mogelijkheden voor vervolgonderzoek betreft de mate waarin we de nadruk hebben gelegd op aspecten van formalisering die het potentieel hebben om de vakgebieden strategisch management, recht en cognitieve psychologie dichter bij elkaar te brengen (zie ook Figuur 10.2). Concepten als informatie verwerking, “sensemaking”, “mindfulness” en vertrouwen hebben bijvoorbeeld hun wortels in cognitieve psychologie, maar zijn hier toegepast op management processen (zie thema’s één, twee, vier en vijf). Een ander voorbeeld bestaat uit contract standaardisering, oorspronkelijk een onderwerp uit de contracten en rechten literatuur. In thema vier is dit construct in verband gebracht met mindlessness, een concept dat voortkomt uit de cognitieve psychologie en met de beheersing van interorganisatorische relaties, een onderwerp in strategisch management. Wij geloven dat veelbelovende richtingen voor vervolgonderzoek geconcentreerd zijn rond de gebieden in Figuur 10.2 waar deze drie disciplines convergeren. Een voorbeeld van een mogelijk onderwerp bestaat uit de redenen die er kunnen bestaan om contracten incompleet en relatief simpel te houden (zie Eggleston et al., 2000). Waar de meerderheid van de contributies in de rechten literatuur veronderstelt dat partners uitkomsten en activiteiten formaliseren op een zodanige wijze dat transactiekosten worden geminimaliseerd, daar suggereren cognitief psychologen dat partners mogelijk niet in staat zijn om te formaliseren vanwege “bounded rationality”, geheugen problemen en angst om de partner onnodig van zijn stuk te brengen. Tegelijkertijd geeft de literatuur over strategisch management aan dat partners mogelijk doelbewust informatie weglaten uit contracten, om te profiteren van informatieasymmetrie en om het grootste deel van de waarde die wordt gecreëerd in een relatie naar zich toe te trekken. Een ander voorbeeld waarin de drie onderzoeksgebieden bij elkaar komen betreft het gebruik van contractuele instrumenten en wettelijke bepalingen om ondernemingsstrategieën te ontwikkelen. Bagley (2005) geeft overtuigend aan dat organisaties veranderingen in wet- en regelgeving pro-actief kunnen gebruiken om nieuwe ondernemingsstrategieën te ontwikkelen. Management cognitie en juridische scherpzinnigheid – de mogelijkheden van managers om de kansen die voortvloeien uit juridische veranderingen te herkennen en na te jagen, vormen hier sleutelementen (Bagley, 2005). Samenvattend stellen we dat deze studie heeft bijgedragen aan de overbrugging van de disciplines strategisch management, recht en cognitieve psychologie, maar we verwachten ook dat er nog een groot aantal andere mogelijkheden bestaan waarmee het raamwerk dat we in deze studie hebben gepresenteerd zou kunnen worden verrijkt, zaken die het verdienen om in vervolgonderzoek te worden geadresseerd. De voorbeelden die we zojuist hebben gegeven, tonen aan dat de rol van formalisering in interorganisatorische relaties ook in de toekomst de aandacht verdient van academici.

CONCLUSIE

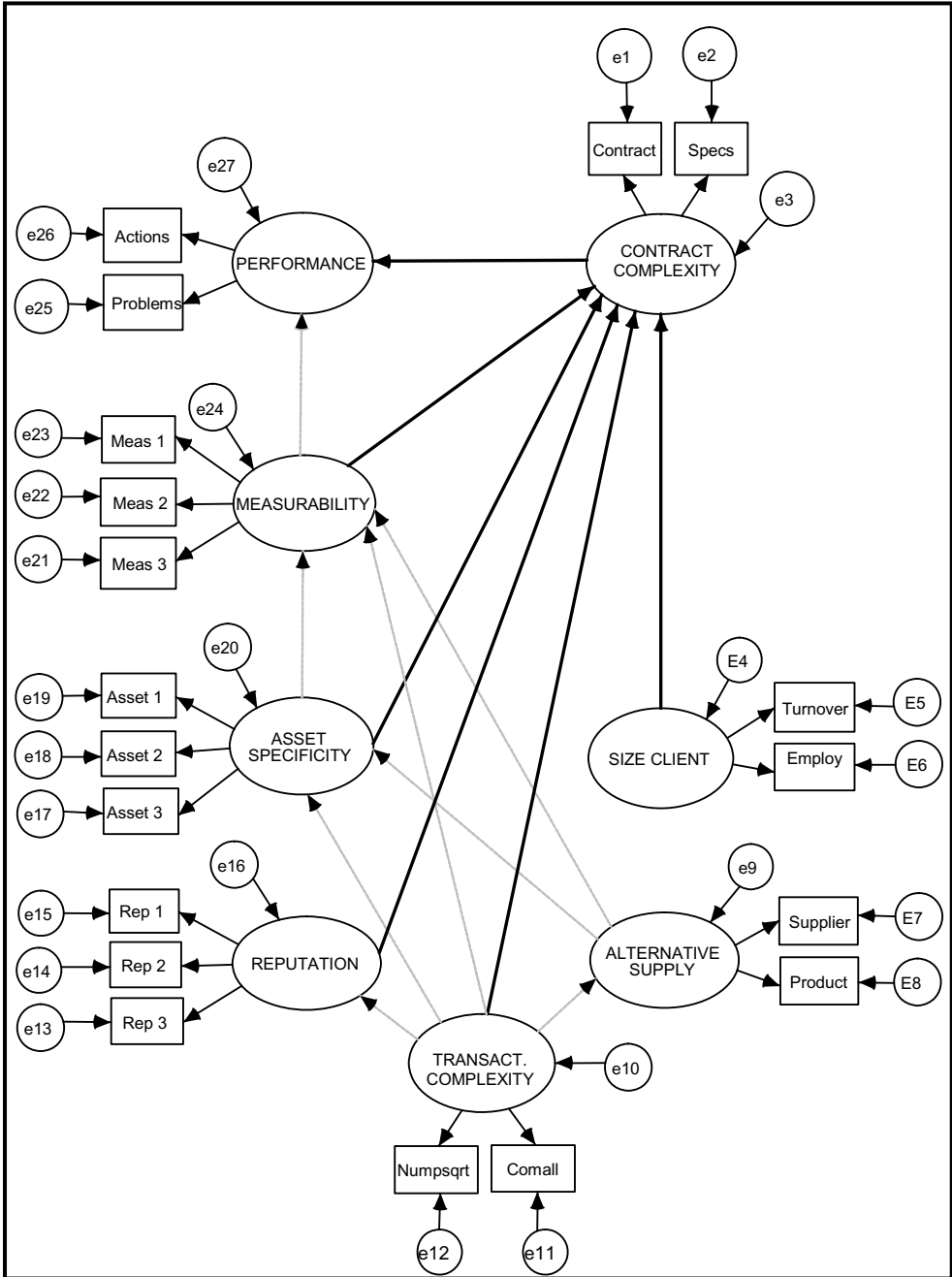
In deze studie hebben we geprobeerd om een coherent beeld te scheppen van de rol van formalisering in interorganisatorische relaties. We hebben dit gedaan door in te gaan op zes onderzoeksthema's. Hieruit bleek dat formalisering een veelzijdig concept is, dat dient te worden gezien vanuit meerdere perspectieven. Onderzoekers en managers dienen zich bewust te zijn van het gezichtspunt of perspectief dat ze innemen wanneer ze zich bezighouden met formalisering. Ze doen er goed aan niet teveel de nadruk te leggen op één enkel perspectief. Ons integrale raamwerk en de discussie van ieder van haar componenten in de zes onderzoeksthema's biedt onderzoekers en managers een vruchtbare basis om het beeld dat ze hebben van de rol van formalisering in interorganisatorische relaties verder te ontwikkelen en te verrijken.

APPENDIX A: CONTRACT LENGTH FOR DIFFERENT AGREEMENTS

Statistics	Type of agreement					
	License agreements	Sales & marketing agreements	Manufacturing & supply agreements	Consultancy agreements	R & D agreements	Strategic cooperation agreements
Mean (# words)	8729	7575	8893	2841	9058	11844
Std. Deviation	7480	6832	9454	2438	7120	12201
Median	6961	5868	6927	2176	6815	7097
Minimum	421	127	256	262	217	423
Maximum	65286	38168	75608	14288	28865	64834
N	591	336	161	73	87	137

Source: data were obtained from onecle.com and analyzed by the author

APPENDIX B: STRUCTURAL EQUATION MODEL



APPENDIX C: FACTOR SCORES, DIRECT EFFECTS, AND MODEL FIT

Factor scores:			Estimate	S.E.	Sign.	Stand. Estimate	
subsample without standard procedures							
Actions	<---	Performance	1.226	.130	.000	.888	
Problems	<---	Performance	1.000			.819	
Asset-specificity 1	<---	Asset-specificity	.907	.084	.000	.704	
Asset-specificity 2	<---	Asset-specificity	.934	.084	.000	.748	
Asset-specificity 3	<---	Asset-specificity	1.000			.660	
Measurability 1	<---	Measurability	.659	.060	.000	.573	
Measurability 2	<---	Measurability	1.090	.076	.000	.853	
Measurability 3	<---	Measurability	1.000			.804	
Alternative suppliers	<---	Alternative supply	1.248	.242	.000	.801	
Alternative products	<---	Alternative supply	1.000			.695	
Number of employees	<---	Size buyer	.610	.155	.000	.735	
Turnover	<---	Size buyer	1.000			.891	
Reputation 1	<---	Reputation	1.457	.143	.000	.866	
Reputation 2	<---	Reputation	1.000			.614	
Reputation 3	<---	Reputation	.933	.090	.000	.664	
Complexity level	<---	Complexity	1.000			.813	
Number of products	<---	Complexity	.490	.044	.000	.750	
Legal specifications	<---	Formalization	3.162	.363	.000	.621	
Trans. specifications	<---	Formalization	1.000			.710	
Direct effects between latent variables:			Estimate	S.E.	Sign.	Stand. Estimate	
subsample without standard procedures							
Alternative supply	<---	Complexity	-.124	.043	.004	-.201	
Asset-specificity	<---	Alternative supply	-.262	.084	.002	-.203	
Asset-specificity	<---	Complexity	.391	.058	.000	.493	
Measurability	<---	Asset-specificity	-.297	.077	.000	-.307	
Reputation	<---	Complexity	.128	.031	.000	.271	
Measurability	<---	Alternative supply	.198	.078	.011	.159	
Measurability	<---	Complexity	-.152	.057	.007	-.198	
Formalization	<---	Measurability	.504	.325	.120	.110	
Formalization	<---	Asset-specificity	1.347	.386	.000	.305	
Formalization	<---	Complexity	1.453	.311	.000	.414	
Formalization	<---	Reputation	1.976	.482	.000	.267	
Formalization	<---	Size buyer	2.084	.597	.000	.254	
Performance	<---	Measurability	.397	.078	.000	.319	
Performance	<---	Formalization	.067	.018	.000	.244	
Model fit: subsample without standard procedures							
	RMSEA	LO 90	HI 90	PCLOSE	NFI	CFI	HOELTER
Default model	.055	.047	.064	.130	.879	.927	239 (.01)
Saturated model					1.000	1.000	
Independence model	.175	.169	.180	.000	.000	.000	39 (.01)
Chi-square = 315.624. Degrees of freedom: 138. Chi-square/degrees of freedom = 2.29							

APPENDIX C: FACTOR SCORES, DIRECT EFFECTS, AND MODEL FIT

Factor scores:			Estimate	S.E.	Sign.	Stand. Estimate	
subsample with standard procedures							
Actions	<---	Performance	1.075	.103	.000	.855	
Problems	<---	Performance	1.000			.837	
Asset-specificity 1	<---	Asset-specificity	.859	.071	.000	.708	
Asset-specificity 2	<---	Asset-specificity	.852	.071	.000	.708	
Asset-specificity 3	<---	Asset-specificity	1.000			.706	
Measurability 1	<---	Measurability	.621	.048	.000	.592	
Measurability 2	<---	Measurability	1.002	.054	.000	.865	
Measurability 3	<---	Measurability	1.000			.855	
Alternative suppliers	<---	Alternative supply	1.405	.216	.000	.847	
Alternative products	<---	Alternative supply	1.000			.670	
Number of employees	<---	Size buyer	1.042	.552	.059	.951	
Turnover	<---	Size buyer	1.000			.624	
Reputation 1	<---	Reputation	1.874	.210	.000	.892	
Reputation 2	<---	Reputation	1.000			.523	
Reputation 3	<---	Reputation	1.156	.119	.000	.645	
Complexity level	<---	Complexity	1.000			.908	
Number of products	<---	Complexity	.456	.032	.000	.792	
Legal specifications	<---	Formalization	3.701	.390	.000	.684	
Trans. specifications	<---	Formalization	1.000			.673	
Direct effects between latent variables:			Estimate	S.E.	Sign.	Stand. Estimate	
subsample with standard procedures							
Alternative supply	<---	Complexity	-.163	.036	.000	-.302	
Asset-specificity	<---	Alternative supply	-.247	.082	.003	-.180	
Asset-specificity	<---	Complexity	.327	.047	.000	.442	
Measurability	<---	Asset-specificity	-.398	.065	.000	-.427	
Reputation	<---	Complexity	.098	.021	.000	.289	
Measurability	<---	Alternative supply	.223	.072	.002	.175	
Measurability	<---	Complexity	-.039	.041	.352	-.056	
Formalization	<---	Measurability	-.661	.292	.023	-.151	
Formalization	<---	Asset-specificity	.899	.334	.007	.220	
Formalization	<---	Complexity	1.133	.223	.000	.376	
Formalization	<---	Reputation	1.709	.534	.001	.192	
Formalization	<---	Size buyer	1.586	.570	.005	.149	
Performance	<---	Measurability	.461	.074	.000	.385	
Performance	<---	Formalization	.037	.018	.034	.136	
Model fit: subsample with standard procedures							
	RMSEA	LO 90	HI 90	PCLOSE	NFI	CFI	HOELTER
Default model	.043	.035	.051	.930	.915	.958	332 (.01)
Saturated model					1.000	1.000	
Independence model	.177	.172	.183	.000	.000	.000	38 (.01)
Chi-square = 258.923. Degrees of freedom: 138. Chi-square/degrees of freedom = 1.64							

APPENDIX D: CORRELATION MATRIX

	Mean	Standard Deviation	Financial volume	Complexity	Asset-specificity	Measurability	Size buyer	Size supplier	Legal expertise	Other relationships	IT-expertise	Importance reputation	Alternative options	Perceived dependence	First user group	Age supplier	Age of the respondent
Financial volume	2.54	1.46	1.00														
Complexity	5.32	2.02	.426	1.00													
Asset-specificity	8.66	3.04	.374	.402	1.00												
Measurability	9.40	2.67	-.278	-.303	-.391	1.00											
Size buyer	5.79	.87	.419	.090	.047	.008	1.00										
Size supplier	3.40	1.47	.383	.127	.165	-.067	.270	1.00									
Legal expertise	.20	.40	.079	-.017	-.016	.042	.131	.047	1.00								
Other relationships	.49	.50	.076	.074	.031	-.036	.050	.006	.054	1.00							
IT-expertise	.78	.41	.111	.001	-.007	.068	.164	.055	.248	.183	1.00						
Importance reputation	11.3	2.09	.214	.189	.214	-.003	.020	.173	.056	.073	.003	1.00					
Alternative options	5.33	1.94	-.219	-.209	-.237	.260	-.111	-.110	.024	-.018	.000	.046	1.00				
Perceived dependence	2.60	1.22	.262	.301	.247	-.212	.037	.135	-.050	.061	.032	.135	-.263	1.00			
First user group	.35	.48	.158	.168	.167	-.231	.080	-.036	.040	.092	.032	.133	-.080	.146	1.00		
Age supplier	2.91	1.22	.287	.049	.066	.061	.275	.546	-.015	.049	.026	.145	-.124	.173	-.054	1.00	
Age of the respondent	38.5	8.81	.065	-.014	-.010	-.022	-.027	.113	-.018	-.053	-.040	-.004	-.050	-.058	.061	.099	1.00
Familiar partner	.50	.50	-.061	-.093	-.154	.173	.000	.092	.063	.005	.032	.074	.077	.012	-.022	.149	.004
Selection efforts	1.58	.71	.501	.310	.373	-.275	.219	.215	.097	.073	.076	.231	-.128	.158	.122	.079	.023
Advance payment	.26	.44	.239	.201	.107	-.110	.044	.040	-.030	.001	-.013	.060	-.068	.123	.035	.005	.007
Negotiation efforts	40.2	7.86	.346	.352	.330	-.147	.088	.158	.089	.070	.032	.329	-.132	.242	.074	.043	-.038
Standard contract	.70	.46	-.240	-.159	-.069	.085	-.161	.036	-.046	-.025	-.013	-.045	.032	-.084	-.104	.029	-.024
Contract completeness	10.7	5.84	.419	.350	.320	-.220	.105	.348	.060	.092	.025	.240	-.173	.247	.083	.176	.050

¹ Correlations with binary variables consist of Kendall's tau-b. Correlations higher than .072 are significant at the 0.05-level, whereas correlations higher than .085 are significant at 0.01-level.

APPENDIX E: ANTECEDENTS OF SIX GOVERNANCE MECHANISMS

	(1)	(2a)	(2b)	(3a)	(3b)	(3c)	(4a)	(4b)	(4c)	(4d)
	Familiar partner	Selection efforts	Selection efforts	Advance payment	Advance payment	Advance payment	Ext. negotiate	Ext. negotiate	Ext. negotiate	Ext. negotiate
Financial volume	n.s.	.323 (.000)	.304 (.000)	1.480 (.000)	1.468 (.001)	1.427 (.002)	.136 (.020)	.125 (.032)	n.s.	n.s.
Complexity	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	.122 (.014)	.113 (.022)	.094 (.056)	.091 (.065)
Asset-specificity	.887 (.005)	.140 (.004)	.110 (.021)	n.s.	n.s.	n.s.	.117 (.017)	.099 (.044)	n.s.	n.s.
Measurability	1.096 (.046)	.184 (.000)	.166 (.000)	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Importance reputation	1.113 (.062)	.113 (.010)	.134 (.002)	n.s.	n.s.	n.s.	.243 (.000)	.254 (.000)	.223 (.000)	.217 (.000)
Alternative options	1.113 (.083)	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Perceived dependence	1.283 (.010)	n.s.	n.s.	1.204 (.075)	1.226 (.053)	1.207 (.079)	.145 (.002)	.161 (.001)	.160 (.001)	.157 (.001)
First user group	.609 (.039)	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Size buyer	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Size supplier	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	.114 (.035)	.114 (.033)	.101 (.059)	.103 (.055)
Legal expertise	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Other relationships	n.s.	.089 (.039)	.088 (.038)	n.s.	n.s.	.664 (.093)	n.s.	n.s.	n.s.	n.s.
IT-expertise	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Age supplier	1.404 (.003)	-.089 (.094)	n.s.	.712 (.008)	.730 (.014)	.715 (.011)	-.122 (.025)	-.101 (.064)	n.s.	n.s.
Age of respondent	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	-.080 (.073)	-.084 (.057)	-.088 (.045)	-.089 (.043)
Familiar partner										
Selection efforts										
Advance payment										
Ext. Negotiations										
Standard contracts										
Number observations	420	459	406	417	.417	405	419	419	.406	404
R ² – Adjusted*	.130 (.174)	.307	.332	.103 (.148)	.107 (.153)	.104 (.149)	.247	.258	.287	.289
Correctly predicted %	65.0	-	-	74.8	75.1	74.3	-	-	-	-

* For the logistic regressions, odds ratios are presented, while for the multiple regressions standardized betas are displayed. The figures between brackets are significance values. Instead of R² – Adjusted, Cox & Snell R² (Nagelkerke R² between brackets) are presented for the logistic regressions.

APPENDIX E: ANTECEDENTS OF SIX GOVERNANCE MECHANISMS (continued)

	(5a)	(5b)	(5c)	(5d)	(5e)	(6a)	(6b)	(6c)	(6d)	(6e)	(6f)
	Standard contracts	Standard contracts	Standard contracts	Standard contracts	Standard contracts	Contract complete	Contract complete	Contract complete	Contract complete	Contract complete	Contract complete
Financial volume	.747 (.009)	.749 (.010)	.778 (.032)	.786 (.043)	.792 (.050)	.231 (.000)	.218 (.000)	.163 (.005)	.120 (.137)	.098 (.061)	.108 (.048)
Complexity	.864 (.040)	.864 (.041)	.854 (.032)	.861 (.042)	.871 (.063)	.080 (.092)	n.s.	n.s.	n.s.	n.s.	n.s.
Asset-specificity	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Measurability	n.s.	n.s.	n.s.	n.s.	n.s.	-.095 (.039)	-.081 (.078)	n.s.	n.s.	n.s.	n.s.
Importance reputation	n.s.	n.s.	n.s.	n.s.	n.s.	.160 (.000)	.172 (.000)	.135 (.002)	.129 (.003)	n.s.	n.s.
Alternative options	n.s.	n.s.	n.s.	n.s.	n.s.	-.080 (.074)	n.s.	-.085 (.062)	-.082 (0.68)	n.s.	n.s.
Perceived dependence	.805 (.041)	.803 (.040)	.815 (.059)	.826 (.080)	n.s.	n.s.	.086 (.057)	.088 (.050)	.077 (.081)	n.s.	n.s.
First user group	n.s.	n.s.	n.s.	n.s.	n.s.	-.080 (.072)	n.s.	n.s.	n.s.	n.s.	n.s.
Size buyer	.627 (.005)	.625 (.005)	.644 (.009)	.638 (.008)	.622 (.006)	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Size supplier	1.471 (.000)	1.471 (.000)	1.472 (.000)	1.479 (.000)	1.510 (.000)	.304 (.000)	.305 (.000)	.289 (.000)	.289 (.000)	.248 (.000)	.251 (.000)
Legal expertise	n.s.	n.s.	n.s.	n.s.	n.s.	.094 (.028)	.094 (.027)	.084 (.047)	.094 (.023)	.075 (.046)	.083 (.036)
Other relationships	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
IT-expertise	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	-.068 (.076)	-.067 (.095)
Age supplier	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Age of the respondent	n.s.	n.s.	n.s.	n.s.	.974 (.080)	n.s.	n.s.	n.s.	n.s.	.071 (.060)	.068 (0.85)
Familiar partner	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	-.137 (.002)	-.085 (.053)	-.074 (.087)	n.s.	n.s.
Selection efforts	n.s.	n.s.	.652 (.032)	.670 (.047)	n.s.	n.s.	n.s.	.221 (.000)	.227 (.000)	.368 (.004)	.119 (.013)
Advance payment	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	.159 (.000)	.141 (.000)	.150 (.000)
Negotiation efforts	n.s.	n.s.	n.s.	n.s.	.964 (.036)	n.s.	n.s.	n.s.	n.s.	.400 (.000)	.405 (.000)
Standard contracts	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Number observations	396	396	384	382	382	419	419	406	404	404	381
R ² - Adjusted	.139 (.193)	.139 (.193)	.152 (.210)	.152 (.210)	.162 (.224)	.309	.325	.350	.373	.486	.463
Correctly predicted %	73.0	72.7	73.7	73.6	73.0	-	-	-	-	-	-

* For the logistic regressions, odds ratios are presented, while for the multiple regressions standardized betas are displayed. The figures between brackets are significance values. Instead of R² - Adjusted, Cox & Snell R² (Nagelkerke R² between brackets) are presented for the logistic regressions.

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Making Sense of Formalization in Interorganizational Relationships

Beyond Coordination and Control

Strategic alliances, buyer-supplier relationships, joint ventures and other forms of interorganizational cooperation increasingly stand at the basis of the competitive advantage of organizations. Although formalization – in the form of contracts, rules and procedures – is considered to be of significant importance for these relationships, an integrative framework of its role has hitherto remained absent in the literature. Drawing on conceptual developments, an in-depth case study and survey data, this study provides such a framework. Six main research findings emerge. First, tensions between the need and the ability to formalize can be reduced by investing in information processing and sensemaking. Second, formalization has functions beyond coordination and control, such as increasing legitimacy and enabling sensemaking. Third, managers are not only occupied with the “right” degree of formalization, but also with managing tensions between its functions and dysfunctions. Fourth, the contribution of formalization to interorganizational performance declines, when it is accompanied by standardization, due to a reduction in the degree of “mindfulness” by contracting parties. Fifth, levels of formalization and trust in early stages of cooperation have a large impact on the evolution and performance of interorganizational relationships, with intermediary levels of both governance forms exhibiting more positive effects than extreme levels. Finally, decisions on formalization are contingent upon the use of other governance mechanisms, which may substitute or complement each other. These findings and the integral framework to which they are connected promise to enrich the understanding that researchers and practitioners have of the role of formalization in interorganizational relationships, and enable them to utilize formalization so that it contributes to performance.

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